

The Advent of Virtual Digital Assets: Analysing Its Status in the Fintech Sector

Shoronya Banerjee

LLM Student, School of Law Christ University, Christ (Deemed-to-be) University, Bengaluru

ABSTRACT

Financial technology brings technology into finance, advancing conversations around big data, artificial intelligence (AI), and machine learning, enabling investment opportunities. However, it is considered to have been introduced and evolved as the Bitcoin protocol in 2009. Digital assets date with the coining of 'bit gold.' This was devised as a decentralised digital currency. The aim behind introducing such a currency was to have a payment mechanism outside the vigilance of the central authority, with a recurring high value. This laid the foundation of blockchain technology, inaugurating the market in digital assets. The utilisation of distributed ledger technology attracted a lot of financial players towards it. Creating digital assets and their required funding subsists on ongoing market changes and investor demands. Computer codes form the skeletal framework of digital assets and depend on agreement-based computer algorithms for effectuating transactions. These digital assets include an almost exhaustive range of virtual assets. Shifting the discussion to the "good faith acquisition" regime, when the transferee of property acquires a good title irrespective of the defect in the title of the transferor, it is known as "good faith acquisition" or "negotiability," an exception to the general rule: *nemo dat quod non habet* ("no one gives what they don't have"). In this scenario, good faith acquisition (negotiability) is quite relevant as digital assets transfer functions based on quite complex structures, which can be deceiving in disputes arising from insolvency, etc. This has been brought to light with the example of a digital asset held in custody by a third-party intermediary. Here, the legal status of the asset is uncertain, which creates the problem of determining who has the right to claim ownership over it. This is where the new legal framework for digital assets is needed to clear the air and award digital tokens the status of 'property' regarding these issues. The proposed legal framework can take due recourse to legal concepts, such as the law of bailment. This paper seeks to analyse and establish the legitimate status of virtual digital assets globally, slowly transitioning to a virtually driven e-community.

KEYWORDS: Virtual digital assets, cryptocurrency, financial technology, blockchain, smart contracts, digital tax

INTRODUCTION

Fintech, or financial technology, introduces the role of technology in finance, which forwards the discussion on big data, artificial intelligence (AI), and machine learning, facilitating investment opportunities. The life-changing impact of technology in finance has brought to light the introduction of virtual digital assets (VDAs) in fintech. Section 2(47A) of the Income Tax Act 1961, the Finance Act of 2022, and the FATF Report cleared the clouds on defining VDAs. According to the FATF Report, 'virtual currencies' are digital units with characteristics of being tradable and serving as a medium of exchange

and unit of account. Courts over time have inferred that VDAs are either an 'intangible property' or a 'good,' reflecting on the evolving nature and multifaceted character of these digital assets within the legal and financial landscape. Shifting the discussion to the adaptability of such currencies, Ethereum and Bitcoin are the crypto giants, fluctuating their value and raising inevitable profits. Users and issuers probably don't even understand the significance of decentralised ledgers but have shifted to utilising them in a short time. This unforeseen profiteering machine has pushed people to be keen on adapting it. However, nobody can ignore the cons being attached to it. The absence of legal regulations exposes these users to record-breaking losses, sweeping off years of savings and dreams. This article attempts to analyse the framework adding fuel to the functionality of cryptocurrencies and the current, viable legal regulations safeguarding all.

TRACING THE EVOLUTION OF DIGITAL ASSETS AND CRYPTOCURRENCIES

Although considered to have been introduced and evolved as the Bitcoin protocol in 2009, digital assets date back to the coining of 'bit gold.' This was formulated as a decentralised digital currency. The aim behind introducing such a currency was to have a payment mechanism outside the vigilance of the central authority, with a recurring high value. This laid the foundation of blockchain technology, inaugurating the market in digital assets. The utilisation of distributed ledger technology attracted a lot of financial players towards it. The continuing creation of digital assets and their funding had to be subjected to ongoing market changes and investor demands. Computer codes form the skeletal framework of digital assets and depend on agreement-based computer algorithms for effectuating transactions. These digital assets include an almost exhaustive range of virtual assets. These virtual assets do not function via a consensus algorithm for verifying transactions or warranting security.¹

Digital assets include cryptocurrencies, security tokens, utility tokens, virtual assets, virtual collectables, stablecoins, altcoins, etc. These are not the same as traditional stocks, mainly because they belong to the digital realm. For instance, Bitcoin itself belongs to the virtual domain. Through blockchain technology, securities offerings and stock transfers mirror physical stock transfers. Directing priority attention towards mobilising decentralised technology has been considered crucial for streamlining the creation and exchange of cryptocurrencies. The prospective features of Blockchain technology attract traditional issuers of securities trying to make their place in the domain of digital assets.

The nascent digital asset market presents an opportunity to establish a new asset class that attracts mainstream investors. The global consensus record of information and transactions enabled through blockchain technology promotes much-needed transparency in finance. At the beginning of the 2020s, investors in the digital asset market ranged from retail to institutional, as well as exchanges, broker-dealers, investment banks, custody providers, IT firms, and other players in the ecosystem. Yet, blockchain technology opens global access to finance, including in areas where the banking system is not readily available and the unbanked constitute significant parts of the population. The Worldwide Consensus Ledger facilitates the maintenance of the transparency of the financial sector. An essential feature of the asset market is the potential to produce a fresh asset category. The blockchain technology holds out global financial accessibility, including regions with limited traditional banking infrastructure, making it possible

¹ Lin, P.Y. (2023) *The history of Digital assets*, CFTE.<https://blog.cfte.education/the-history-of-digital-assets/> (Accessed on: 28. 10. 2023).

to serve considerable portions of the unbanked population.²

Crypto assets have financial and non-financial uses. The gross market capitalisation of all crypto-assets was estimated to be more than \$1 trillion as of February 2023.³ The adoption of crypto-assets and smart contract programming, from cross-border aid distribution and allowances to the innovative transformation of conventional financial functions, is experiencing unwavering growth. Therefore, regulatory attention shall include the benefits, financial stability and integrity, prohibiting illicit finance and consumer protection concerns. A “stablecoin” crash in 2022 sent shockwaves through the industry. The 2022 failure emphasised the significance of applying technology for transparency, risk mitigation and innovation in crypto-asset activities. Looking at the regulatory approaches differ across jurisdictions. Local markets, public and private actors, regional priorities, etc, have become the reason for regulatory fragmentation and a deepening uncertainty on the status of the crypto environment across borders.⁴

RENDERING THE STATUS OF LEGAL TENDER: THE PREVAILING UNCERTAINTY

The significance of money is radiated through its use as a medium of exchange. Cryptocurrencies are generally not used to conduct transactions. 2008 witnessed the introduction of Bitcoin, a trial towards establishing an electronic currency to outmanoeuvre the need for traditional financial institutions. This further evolved into investment assets but couldn't replace the paper-based legal tenders to conduct payments. The value of currencies differs over time, but with the absence of legal regulations of cryptocurrencies, their value fluctuates drastically, making users question it since, at one point, cryptocurrencies must be converted into fiat money. This reveals all the exchange-rate risks. Looking at the acceptance rate, the city of Lugano in the Italian Swiss Canton accepted Bitcoins and stablecoin Tether as legal tenders. Rovereto and the Trentino region in Italy are considered to be Bitcoin Valley. As per 2018 data, out of 45 activities accepting Bitcoin, 18 were in Rovereto.⁵

The Indian Scenario

India has been using Bitcoin since 2012. A governmental committee was formed in 2017 to push for specific legislation categorically classifying the trade of cryptocurrencies as illicit. In February 2018, the Finance Minister of India, Arun Jaitley, conveyed the associated problems through his budget speech. According to his address, the government was dedicated to ascertaining a way of restraining the usage of virtual currencies in India. It was emphasised that the country did not render a legal status on digital currencies but only tried to promote blockchain technology for modifying payment systems. Individuals were cautioned against using this legitimately unregulated currency to prevent fraud.

The Reserve Bank of India's (RBI) step to ban cryptocurrency was opposed mainly by investors and other financial players. Concerning this, the Internet & Mobile Association of India (IAMAI) came forward to represent all the petitions. Further, on the intervention of the Apex Court, some key issues were brought

²Kaal, W.A. *Digital Asset Market Evolution* - jcl.law.uiowa.edu, Digital Asset Market Evolution. https://jcl.law.uiowa.edu/sites/jcl.law.uiowa.edu/files/2021-08/Kaal_Final_Web_0.pdf (Accessed on: 28. 10. 2023).

³*Pathways to the Regulation of Crypto-Assets: A Global Approach*, World economic forum (2023) https://www3.weforum.org/docs/WEF_Pathways_to_the_Regulation_of_Crypto_Assets_2023.pdf (Accessed on: 28. 10. 2023).

⁴*Blockchain: Financial and Non-Financial Uses and Challenges*, GAO (U.S. Government Accountability Office) (24. March, 2022), <https://www.gao.gov/blog/blockchain-financial-and-non-financial-uses-and-challenges> (Accessed on: 28. 10. 2023).

⁵Scafile, D. (1970) *An exploratory study investigating cryptocurrencies acceptance as a form of payment: The case of smes in Italy and Switzerland* | Mémoire UCL. <https://dial.uclouvain.be/memoire/ucl/en/object/thesis%3A35319> (Accessed on: 28. 10. 2023).

to light. Could cryptocurrency be utilised in place of traditional currency if RBI could regulate it, and was RBI well within the ambit of its authority? Further, on this issue, it was argued that the RBI had exceeded its statutory authority by creating obstacles and trying to ban the use of cryptocurrencies. It was considered that RBI's role in intervening in economic matters breached Article 19(1)(g) of the Indian Constitution, obstructing individuals from engaging and practising any profession, occupation, trade, or business of their choice. The court's contention here was whether this justified the doctrine of proportionality. The court was against the RBI's blanket ban on cryptocurrency usage while applying an "excessive exercise of power that was manifestly arbitrary, based on non-reasonable classification, and imposed disproportionate restrictions."⁶

The Reserve Bank of India's (RBI's) default loss guarantee guidelines side with the fintech clearing the cloud for lending arrangements with banks and Non-Banking Financial Companies (NBFCs). The RBI-approved FLDG scheme involves an unregulated entity guaranteeing regulated lenders when a borrower defaults. Here comes the role of a fintech company or a Lending Service Provider (LSP). It assures a specific portion of the default loan portfolio held by registered entities such as banks and NBFCs. FLDGs propose an opportunity for fintech companies to exhibit their indemnifying competence and build trust with banks and NBFCs. Fintech companies have provided FLDG guarantees of up to 100% to their partners, leading to banks and NBFCs facing severe losses for borrower defaults when the fintech couldn't fulfil its commitments. Through this FLDG arrangement, the RBI has set the default guarantee not to exceed 5% of the portfolio amount. This arrangement can only be between an RBI-regulated entity and an LSP or two regulated entities that are parties to an outsourcing agreement.⁷

EXPLORING THE TECHNOLOGY AND SECURITY ASPECTS OF VDAs

The Securities Contract Regulation Act 1956 has defined "securities" under Section 2(h). It consists of marketable securities within incorporated companies, government securities, and any instruments notified by the Central Government as securities. The statutory definition is flexible, expanding and extending the scope of "securities" to cover additional instruments. One also has to note "marketability" in this regard. It discusses the market dynamics that ensued on the security, without considering its size, with high liquidity and ease of transfer. This works for publicly listed company securities. Further, Virtual Digital Assets (VDAs) are also tradable on cryptocurrency exchange platforms. However, without statutory guidelines, potential legal violations are rampant. VDAs can be fiat currency, with its growing sector and potential for liquidity, equating them with marketable securities. The discrepancy is of the role played by an incorporated company as crypto assets are created under anonymity, with the issuer being unidentified. Although platforms like ZebPay have integrated themselves with the Registrar of Companies (ROC), they also offer IT and software services. The ROC has rejected attempts to establish new companies in India specifically for cryptocurrency exchange operations. In some cases, the ROC has requested applicants to provide an undertaking that they will not deal with cryptocurrencies like Bitcoin without obtaining prior approval from the RBI.

⁶Kumar, S. and Kumar, H. (2023) 'LEGAL STATUS OF CRYPTOCURRENCY IN INDIA', Shodhasamhita, <https://www.researchgate.net/publication/370635209> LEGAL STATUS OF CRYPTOCURRENCY IN INDIA. (Accessed on: 26. 10. 2023)

⁷Nirav Choksi, *How RBI's New FLDG Guidelines Broaden The Horizons Of Fintech Innovations*, Inc42(12. June, 2023), <https://inc42.com/resources/rbis-new-fldg-guidelines-broaden-the-horizons-of-fintech-innovation/> (Accessed on: 26. 10. 2023)

Further, The Securities Contract Regulation Act 1956 defines “good” as “every kind of movable property other than actionable claims, money, and securities.” This property can be tangible and intangible. cryptocurrency meets the concept of “good” because it is a transferable set of codes used with blockchain technology. Following Section 2(bc) of the Act, contracts for the delivery of certain items announced by the Centre that are not ready for delivery contracts introduce the aspect of commodity derivatives where there is a possibility of adding digital assets to the commodity derivatives market on stock exchanges. SEBI FAQ⁸ lists requirements for registered commodities, although it suggests that digital assets as a commodity are not acceptable. Classifying Virtual Digital Assets (VDAs) as “securities” would make SEBI the fundamental regulatory body. Directives, bylaws, etc. will be put forth by SEBI. SEBI would possess the authority to issue directives and modify the bylaws of recognised crypto exchanges. Compliance with Know Your Customer (KYC) would be a compulsion to ensure the safety of investors. SEBI would extend its authority to resolve disputes arising in the crypto asset market.⁹

DISCUSSING BLOCKCHAIN TECHNOLOGY AND SMART CONTRACTS

Blockchain technology

Public databases storing digital information are referred to as Blockchain. This database includes all information on the transactions, including the buyer and seller’s unique information of that specific buyer and seller. Blockchain, therefore, provides an encrypted digital currency that works independently as units or blocks. Blockchain technology consists of a peer-to-peer network in which every web user has information on all the transactions made within that network. Transactions are made using Cryptocurrency wallets. Blockchain provides a unique solution to high operation costs, low efficiency and data storage risks in traditional centralised systems. Blockchain is widely known to be a riotous innovation of the computing paradigm after the mobile, Internet, and social media. Blockchain can be considered as the future Internet of Value.

Cryptocurrency is logically only data recorded on a decentralised platform where users function without a middle authority. It is similar to trading in stock exchanges. Encryption algorithms are its medium of security. Public Key and Private Keys transfer Cryptocurrency from one account to a specific account. Encrypted transactions broadcast these requests, which are queued and later added to the Blockchain, which, in this case, is a public ledger. Blockchain available to the users gives out all the information on the transactions. However, Cryptocurrency does not reveal the identity of the user; the user has the keys to access the account and the information. All these transactions are added onto the Blockchain, and they form queues. They are then added block by block, creating a chain of blocks. Looking at Blockchain technology, the public can access it through public addresses like our emails. However, addresses used in Blockchain to send money still have a sense of secrecy as one can send money to an address but can’t tell from whom it was sent. This matter is handled by introducing encoded QR codes for one to scan and transfer. Then, the sender’s wallet digitally signs the transaction with their private key. Therefore, the public address is used here to verify the authorisation of the transaction.¹⁰

⁸Securities and Exchange Board of India, *FAQs ON COMMODITY DERIVATIVES*, https://www.sebi.gov.in/sebi_data/faqfiles/nov-2021/1636459721896.pdf.

⁹Shah, D. (2023) *Virtual Digital Assets (vdas): ‘securities’ or not?*, Centre for Business and Commercial Laws. https://cbcl.nliu.ac.in/capital-markets-and-securities-law/virtual-digital-assets-vdas-securities-or-not/#_ftn3 (Accessed on: 27. 10. 2023).

¹⁰ Bashar Ibrahim Hameed, *Blockchain and Cryptocurrencies Technology: A Survey*, 3 International Journal On Informatics Visualization 355-358 (2019). (Accessed on: 10. 01. 2024)

Smart contracts

While trying to justify the legal plausibility of cryptocurrencies, the ambiguities and search for legal backing take us to the possible intervention of smart contracts. In this case, the digital asset forms the element of consideration of a valid contract. In this scenario, the legality of the consideration and enforceability of the contract very well depends on the legal validity of cryptocurrencies themselves. The cryptocurrency conundrum and what 'smart contracts' are also dependent on increasing the scope of the Indian Contract Act.

As discussed earlier, smart contracts are computer codes considered to automatically perform the agreement and subsequently store it in the blockchain platform. It could easily complement the agreement on paper and execute parts of it, facilitating the easy transfer of money from one party to another. This code exists across several intersections of the blockchain platform, making it rigid, secure and durable. To execute a transaction, certain conditions have to be met; therefore, if it is fed in the system that certain conditions have been met, then the code carries out a step according to it. Significantly, a step wouldn't have been taken if the transaction had not been initiated. Smart contracts are usually written in one programming language.¹¹ As per the Indian scenario, there are no special legislations to deal with smart contracts mainly. The primary reference is made to the Indian Contract Act. Achieving a higher Ease of Doing Business ranking means ensuring pre- and post-contracting procedures are efficient.

REGULATION OF VIRTUAL DIGITAL ASSETS IN INDIA UNDER PMLA

Virtual Digital Assets (VDAs) bring potential dangers related to money laundering, terrorist financing, tax evasion, etc. Although legal ambiguity floats for this reason, one cannot ignore the intensity of requirements for the governmental bodies to establish regulations to guarantee the legality, security, and transparency of VDAs. The Reserve Bank of India's (RBI) 2013 Circular was a step to caution against virtual currencies as the market was unstable and unregulated. In 2017, the RBI mentioned that it had not granted any "license/authorisation to any entity/company to operate such schemes or deal with Bitcoin or any virtual currency." Therefore, such investments were made at their own risk. Further, in 2018, a ban was imposed on virtual currencies (VCs) for being defenceless to hacking, creating a leeway for risky activities. However, in 2020, the ban was raised following the *Internet and Mobile Association of India v. Reserve Bank of India* case.¹² This decision provided relief to the country's cryptocurrency industry. The Supreme Court reasoned that the circular issued by the RBI violated the rights protected by Article 19(1)(g) and went against the principle of proportionality. The court suggested that issuing guidelines would have been a more balanced response than an entire categorical ban.¹³

Revising the Prevention of Money Laundering (Maintenance of Records) Rules extended its application of Know Your Customer (KYC) standards to include entities associated with Virtual Digital Assets (VDAs). In March 2023, a significant notification was issued by the Department of Finance, Ministry of Finance, in alignment with Section 2 (1) (sa) (vi) of the Prevention of Money Laundering Act, 2002 (PMLA) to expand the ambit of "person carrying on designated business or profession" as it was required

¹¹ Alex Lipton, *An Introduction to Smart Contracts and Their Potential and Inherent Limitations*, (May 26, 2018), <https://corpgov.law.harvard.edu/2018/05/26/an-introduction-to-smart-contracts-and-their-potential-and-inherent-limitations/>. (Accessed on: 15. 01. 2024)

¹²2020 SCC online SC 275.

¹³Gaurav Pandey, *Regulation of Virtual Digital Assets in India: Additional Obligations on Service Providers under the purview of PMLA*, TaxGuru <https://taxguru.in/corporate-law/regulation-virtual-digital-assets-india-pmla.html>. (Accessed on: 10. 02. 2024)

to include specific activities and transactions associated with VDAs.¹⁴ Actions were further specified under the purview of subclause (vi) of clause (sa) of subsection (1) of section 2 of the Prevention of Money Laundering Act, 2002, when conducted for or on behalf of another natural or legal person in the course of business like exchanging and transferring virtual digital assets and fiat currencies, etc. Safekeeping or administration of virtual digital assets or instruments that enable control over virtual digital assets. Therefore, Virtual Assets Service Providers (SPs) are referred to as reporting entities under the PMLA; these entities must abide by compliance requirements under the PMLA and the Prevention of Money Laundering (Maintenance of Records) Rules, 2005. In 2021, the Ministry of Corporate Affairs changed Schedule III of the Companies Act 2013 by mandating companies to include specific disclosures in their financial statements starting from April 4, 2021, relating to their profits or losses and the extent of virtual currencies held. Companies engaging in transactions or investments involving cryptocurrency or virtual currency had to give information on the profit or loss incurred from dealings related to cryptocurrency or virtual currency, details of any deposits or advances received from individuals for trading, etc.¹⁵

TAXABILITY OF VIRTUAL DIGITAL ASSETS

The 2022 budget speech of the Finance Minister of India incorporated the announcement of taxing cryptocurrencies, initiating the legalisation of cryptocurrencies. 30% tax and a 1% Tax Deducted at Source (TDS) would be levied on any income generated from transferring digital assets and payments related to transferring virtual digital assets that exceed a certain monetary threshold. To consider this as a con or a step towards the legalisation of cryptocurrencies is a question of concern. Encrypted digital data strings represented by cryptocurrency constitute units of currency. Nasscom and WazirX conducted projections indicating that crypto asset investments could reach \$241 million by 2030.

The tax proposal introduced the concept of virtual digital assets (VDA) and added clause 47A under Section 2 of the Income Tax Act to define virtual digital assets further. It surrounds information, code, number, or token generated through cryptographic or similar methods, excluding Indian or foreign currency. It offers a digital representation of value, whether exchanged with or without consideration and carries a promise or representation of inherent value. It is a unit of account or store of value used for financial transactions, not limited to investment schemes. It can be electronically transferred, stored, or traded. The definition of VDA included Non-fungible tokens (NFTs). Any other digital assets that may be officially notified. The central government can exclude specific assets from being considered Virtual Digital Assets.

Section 115BBH, inserted in the Income Tax Act, outlined the income generated from the sale of virtual digital assets, including cryptocurrency and NFTs, to be subjected to a standard tax rate of thirty per cent. The taxable income was calculated by deducting the acquisition cost from the sales consideration. Only the acquisition cost is eligible for deduction when determining the tax liability, with no other deductions allowed. Losses from other sources of income cannot be offset against income derived from virtual digital assets. Similarly, losses from the sale of VDAs cannot be offset against income from any other source. Losses incurred from the sale of virtual digital assets cannot be carried forward. The gifting of virtual digital assets is now subject to taxation and has been included in the property definition as clause (d) of the Explanation to Clause (vii) of Section 56. This means gifts with a valuation exceeding Rs. 50,000 will

¹⁴ Ashima Obhan and Aparna Amnerkar, *India: Virtual Digital Assets Under The Ambit Of PMLA*, mondaq (16. March, 2023), <https://www.mondaq.com/india/fin-tech/1294436/virtual-digital-assets-under-the-ambit-of-pmla> (Accessed on: 10. 02. 2024)

¹⁵*Ibid*

be taxable for the recipient. A 1% deduction at the source of the payment amount, to be deposited with the government, has been proposed.¹⁶

Tax Deducted at Source (TDS) is a mechanism designed to levy taxes on cryptocurrency traders and investors at the time of each transaction by withholding a certain percentage of the payment at the source. When a buyer owes a payment to a seller, they must deduct the specified TDS amount and remit it to the central government. The remaining balance is then paid to the seller. The TDS rate for cryptocurrency transactions in India has been set at 1%. Starting from July 01, 2022, the buyer is responsible for deducting TDS at the 1% rate when making payments to the seller for the transfer of Crypto/NFT. Transactions on cryptocurrency exchanges may handle the deduction of TDS and transfer the balance to the seller. Indian exchanges automate the TDS deduction process, but individuals trading on foreign exchanges must manually deduct TDS and file their TDS returns. The high TDS has pushed users to have an affinity for non-compliant foreign exchanges for trade.¹⁷

Ratifying and recording transactions on a blockchain network is what is referred to as mining. Within a blockchain network, miners compete to verify transactions. Income derived from mining is subject to a flat tax rate of 30%. When calculating gains at the time of sale, the acquisition cost for crypto mining is considered 'Zero.' This means that no expenses, such as electricity or infrastructure, can be factored into the acquisition cost for tax calculations. Looking at the transaction types in P2P transactions, the buyer is responsible for deducting TDS and submitting either Form 26QE or 26Q, depending on the situation. For example, this applies when purchasing cryptocurrency using Indian Rupees (INR) on a P2P platform or an international exchange. In Crypto-to-Crypto Transactions, TDS applies to both the buyer and the seller at a rate of 1%. This includes transactions such as buying crypto with stablecoins.¹⁸

FUTURE REFORMS AND RECOMMENDATIONS

A coordinated global approach and regulatory framework are essential to channel the benefits of the underlying technology and effectively manage the potential risks, including regulatory arbitrage and the interconnections within the crypto-asset ecosystem that could spill over into traditional financial systems. However, considering the varying levels of market maturity, the emergence of regional hubs, and differences in regulatory capabilities, it is wise to take an integrated perspective on the crucial roles that international organisations, national and regional regulators, and industry participants can collectively play in shaping responsible regulatory progress. The challenge associated with cryptocurrencies is rooted in the difficulty of tracing the sources of transactions. Although the transactions themselves are transparent and can be verified, the actual origins of these transactions are frequently concealed. This lack of traceability impedes the ability to determine the sources of funding. Additionally, cryptocurrency mixers add another layer of complexity to the obscurity of cryptocurrency funds, rendering Virtual Digital Assets (VDAs) susceptible to potential exploitation by malicious individuals.

It is essential to encourage the adoption of a unified taxonomy and classification system for crypto-assets and related activities and promote technology-neutral principles and standards that promote international

¹⁶ Shawaiz Nisar, *Digital Currency Taxation Proposals – Features And Way Forward*, Khurana&Khurana (28. February, 2022), <https://www.khuranaandkhurana.com/2022/02/28/digital-currency-taxation-proposals-features-and-way-forward/> (Accessed on: 28. 10. 2023)

¹⁷ *Taxation framework of virtual digital assets (VDAs): An overview*, pwc, <https://www.pwc.in/tax-knowledge-hub/taxation-framework-of-virtual-digital-assets.html> (Accessed on: 28. 10. 2023)

¹⁸ Ektha Surana, *Taxation on Cryptocurrency: Guide To Crypto Taxes in India 2023*, ClearTax(8. June 2023), <https://cleartax.in/s/cryptocurrency-taxation-guide>(Accessed on: 28. 10. 2023)

alignment on the legal classification of crypto-assets and associated activities. Define best practices and fundamental regulatory measures to achieve the desired regulatory goals. Foster the ability for entities to operate across borders and facilitate data sharing. A step could be taken towards establishing transparent practices for critical functions, including custody, transfer, settlement, and tracking illicit activities, as well as fundamental regulatory standards related to AML/KYC, consumer protection, and market integrity. Encourage a nuanced, evidence-based approach to implementing these best practices to ensure that technology solutions and regulatory standards work together seamlessly. International regulatory guidelines that discuss how various jurisdictions have integrated crypto-assets into their national frameworks have to be created, focusing on identifying and disseminating best practices. This approach will provide businesses with certainty and incentivise compliance with the best rules and regulatory standards, ultimately fostering trust within the ecosystem and protecting users.

Further, defining standards for sharing data and insights is vital to enhance interoperability among stakeholders, such as crypto service providers, financial institutions, enforcement authorities, and analytics service providers. Promote the ability of registered and licensed entities to operate across borders, facilitating international coordination and addressing cross-border risks. The ongoing exchange of information about threats, vulnerabilities, and enforcement actions is a dissuasion to malicious actors seeking to exploit the ecosystem. Furthermore, the concept of passportability will empower global coordination efforts.

CONCLUSION

The cryptocurrency market is inevitable with the societal digital transformation. While its presence is being accepted and acknowledged, imposing taxes on Virtual Digital Assets (VDAs) suggests a form of implicit approval. Despite benefiting from this unregulated and high-risk industry, formulating and introducing a comprehensive regulation is hesitated upon, as money laundering and terrorist financing are the possible consequences of it. Even the advertising of VDAs is subject to restrictions, as it could affect market volatility, clarifying the dilemma of whether or not to consider them as securities in India. Given these circumstances, it is advisable to categorise VDAs as securities until a permanent legal framework is established or Indian jurisprudence gains sufficient clarity on their nature. This can be achieved through a government notification officially designating VDAs as marketable securities. However, SEBI must be well-prepared to address the significant challenges of such a move. It has to be understood that a lack of regulation poses more significant risks than initiating a developing regulatory framework.

BIBLIOGRAPHY

Online resources:

1. Shah, D., *Virtual Digital Assets (vdas): 'securities' or not?*, CBCL <https://cbcl.nliu.ac.in/capital-markets-and-securities-law/virtual-digital-assets-vdas-securities-or-not/>
2. World Economic Forum, *Pathways to the Regulation of Crypto-Assets: A Global Approach* (May, 2023) https://www3.weforum.org/docs/WEF_Pathways_to_the_Regulation_of_Crypto_Assets_2023.pdf
3. Athira Sankar, *Crypto & Blockchain*, Nishith Desai Associates https://nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Crypto_and_Blockchain.pdf.
4. Michael B Greenwald, *How Digital Assets will Impact Financial Inclusion and Energy Consumption*, Belfer Center for Science and International Affairs, Harvard Kennedy School

<https://www.belfercenter.org/publication/how-digital-assets-will-impact-financial-inclusion-and-energy-consumption>.

5. Madhu Gadodia, *[The Viewpoint] Regulation of virtual digital assets in India*, Bar and Bench <https://www.barandbench.com/law-firms/view-point/regulation-of-virtual-digital-assets-in-india>.
6. Stuart D Levi and Alex B. Lipton, *An Introduction to Smart Contracts and Their Potential and Inherent Limitations*, Harvard Law School Forum on Corporate Governance (May 26, 2018), <https://corpgov.law.harvard.edu/2018/05/26/an-introduction-to-smart-contracts-and-their-potential-and-inherent-limitations/>