



### **INTRODUCTION**

# • <u>Introduction to the Blockchain</u>

- o Blockchain is a public ledger which facilitates the process of recording transactions and tracking assets in a business network.
- o It can be programed to track and record anything of value.
- A Blockchain is essentially a database where the data is stored in blocks, which are linked to each other in a sequential order.

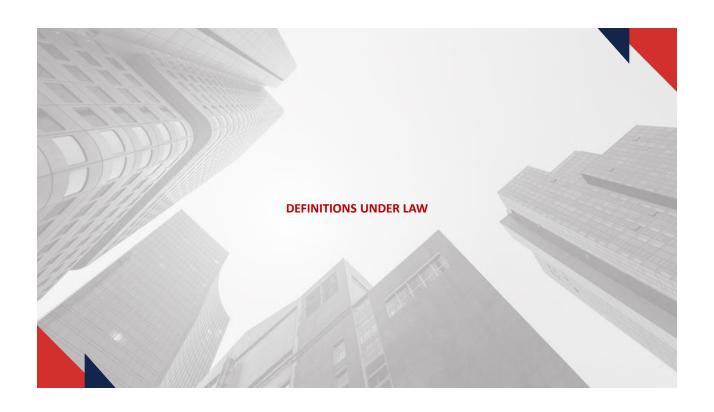
#### INTRODUCTION

# • What are Cryptocurrencies?

- o A Cryptocurrency is a digital currency designed to work as a medium of exchange.
- o It operates through a computer network that is not reliant on any central authority, such as a government or a bank.

## What are NFTs?

- o NFT is a "one of a kind" non-fungible digital asset which tokenise underlying asset using a suitable blockchain.
- An NFTs is a mutually uninterchangeable unit of data stored on a blockchain that can be sold and traded
- o An NFT may be associated with digital files such as photos, videos, and audio.



### **DEFINITIONS UNDER LAW**

## Finance Bill, 2022:

"virtual digital asset" means—

- (a) any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically;
- (b) a non-fungible token or any other token of similar nature, by whatever name called;

(Contd.)

### **DEFINITIONS UNDER LAW**

(c) any other digital asset, as the Central Government may, by notification in the Official Gazette specify.

Provided that the Central Government may, by notification in the Official Gazette, exclude any digital asset from the definition of virtual digital asset subject to such conditions as may be specified therein.

Explanation.—For the purposes of this clause,—

- (a) "non-fungible token" means such digital asset as the Central Government may, by notification in the Official Gazette, specify;
- (b) the expressions "currency", "foreign currency" and "Indian currency" shall have the same meanings as respectively assigned to them in clauses (h), (m) and (q) of section 2 of the Foreign Exchange Management Act, 1999.

#### **DEFINITIONS UNDER LAW**

## Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019:

"Cryptocurrency", by whatever name called, means any information or code or number or token not being part of any Official Digital Currency, generated through cryptographic means or otherwise, providing a digital representation of value which is exchanged with or without consideration, with the promise or representation of having inherent value in any business activity which may involve risk of loss or an expectation of profits or income, or functions as a store of value or a unit of account and includes its use in any financial transaction or investment, but not limited to, investment schemes.



### **COMPANIES ACT DISCLOSURES**

<u>Vide a notification dated 24<sup>th</sup> March 2021, the MCA has amended Schedule III of the Companies Act to include the following additional disclosures with respect to virtual currencies</u>:

- Where the Company has traded or invested in Cryptocurrency/Virtual Currency during the financial year, the following shall be disclosed:
  - o profit or loss on transactions involving Cryptocurrency/Virtual Currency.
  - o amount of currency held as at the reporting date.
  - o deposits or advances from any person for the purpose of trading or investing in Cryptocurrency/virtual currency.

## **COMPANIES ACT COMPANIES ACT DISCLOSURES**

- Where the company covered under section 135 of the Companies Act, the following shall be disclosed with regard to CSR (Corporate Social Responsibility) activities:
  - o amount required to be spent by the company during the year
  - o amount of expenditure incurred
  - o amount of expenditure incurred
  - o total of previous years shortfall
  - o reason for shortfall
  - o (Contd.)

### **COMPANIES ACT COMPANIES ACT DISCLOSURES**

- Where the company covered under section 135 of the Companies Act, the following shall be disclosed with regard to CSR (Corporate Social Responsibility) activities:
  - o nature of CSR activities
  - o details of related party transactions contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard
  - o where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately

### **RBI NOTIFICATION ON VIRTUAL CURRENCY DUE DILIGENCE**

RBI notification dated May 31, 2021, on "Customer Due Diligence for transactions in Virtual Currencies":

- Sets aside the RBI circular dated April 6, 2018, on "Prohibition on dealing in Virtual
  Currencies" in light of Supreme Court's decision in <u>Internet and Mobile Association of India v.</u>
  Reserve Bank of India.
- Provides that entities regulated by RBI should carry out customer due diligence processes in line with regulations governing standards for Know Your Customer (KYC), Anti-Money Laundering (AML), Combating of Financing of Terrorism (CFT) and obligations of regulated entities under Prevention of Money Laundering Act, (PMLA), 2002.
- Additionally, entities regulated by RBI must ensure compliance with relevant provisions under Foreign Exchange Management Act (FEMA) for overseas remittances.

## STATUS OF VIRTUAL DIGITAL ASSETS AS SECURITIES

## Securities include:

- shares, scrips, stocks, bonds, debentures, debenture stock or other marketable
- securities of a like nature in or of any incorporated company or a pooled
- investment vehicle or other body corporate;
- derivative;
- units or any other instrument issued by any collective investment scheme to
- the investors in such schemes;
- rights or interest in securities;

### STATUS OF VIRTUAL DIGITAL ASSETS AS SECURITIES

Two criteria need to be fulfilled for an instrument to qualify as a "security":

- it should be 'marketable'; and
- it should be of a nature 'like' shares, scrips, stocks, bonds, debentures, debenture stock.

Guiding principles for an instrument to be deemed a security under Section 2(h)(i):

- it ought to be like shares, scrips, stocks, bonds or debentures;
- it ought to be freely transferable, including free from any statutory restrictions on transfer; and
- it ought to be transferable in a market, that is, a stock exchange or a place where such instruments can be readily sold.

### STATUS OF VIRTUAL DIGITAL ASSETS AS DERIVATIVES

Derivatives are in the nature of contracts. The standing committee's 1999 report basis which the term 'derivative' and consequent provisions were introduced in the definition of a security defines a derivative as a forward, future, or option, contract of a pre-determined fixed duration, linked for the purpose of contract fulfilment to the value of a specified real or financial asset or index of securities.

Commodity Derivatives under section 2(bc) means a contract

- 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
- 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.

## **RIGHTS OF INTEREST IN SECURITIES**

- In view of Section 2(h)(iii) of the SCRA, a right or an interest in a security is also a security.
- Prime examples of such securities are depository receipts, which are essentially certificates or receipts created by a bank situated outside India and issued to non- resident investors against the issue of the shares of an Indian company. Indian Depository Receipts, Global Depository Receipts and American Depository Receipts are common examples in India

#### **EXCHANGES**

A stock exchange, as defined under Section 2(j) of the SCRA, means a body of individuals or a body corporate incorporated under the Companies Act, 1956 which assists, regulates, or controls the business of buying, selling, or dealing in securities. A 'recognised stock exchange' is one that is recognized by the Central Government provided that prescribed provisions of the SCRA are met.

Section 19 of the SCRA states that:

"No person shall, except with the permission of the Central Government, organise or assist in organising or be a member of any stock exchange (other than a recognised stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities"

Therefore, in the event that virtual digital assets are recognised as securities, it will be prohibited to exchange such assets except on recognised exchanges.

#### VIRTUAL DIGITAL ASSETS AS COLLECTIVE INVESTMENT SCHEMES

As per section 11AA of the Securities and Exchange Board of India Act, 1992, in order for any scheme to constitute a Collective Investment Scheme ("CIS"), the following conditions need to be fulfilled:

- any contributions or payments made by the investors are pooled and utilized for the purpose of the scheme/arrangement; Section 11AA, Securities and Exchange Board of India Act, 1999;
- the contributions or payments are made to such scheme/arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable, from such scheme or arrangement;
- the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;
- the investors do not have day-to-day control over the management and operation of the scheme/arrangement.

all four conditions collectively need to be fulfilled for a scheme to constitute a CIS.

### **VIRTUAL DIGITAL ASSETS AS COLLECTIVE INVESTMENT SCHEMES**

- In *Paramount Bio-Tech Industries Ltd. v. Union of India*, a Division Bench of Allahabad High Court has held that in order to gauge that whether an instrument is a "collective investment scheme" or not, the Court shall use the Howey test.
- The Howey test, laid down by US Supreme Court in Securities and Exchange Commission v. W.J. Howey Co. lists three main features of an investment contract: (i) involves an investment of money; (ii) investor has an expectation of profit; and (iii) the profit is generated by the issuer.

### TAX IMPLICATION ON VIRTUAL DIGITAL ASSETS

# With effect from April 1, 2022, the following tax obligations are applicable to virtual digital assets:

- Income from the transfer of virtual digital assets will be taxable at a flat rate of 30% without the ability to offset it against any other losses.
- No deductions will be allowed and only the cost of acquisition will be allowed as deduction while computing income.
- There will be a requirement for the tax to be deducted at source at the rate of 1% on payment to a resident on the transfer of virtual digital assets.
- A gift of virtual digital assets will be taxable at the hands of the recipient

