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## Cryptocurrency- An analysis of risks and regulatory framework in India

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### Abstract

The rise of cryptocurrencies has revolutionized financial markets globally, presenting both opportunities and challenges. Crypto-currencies have gained enormous traction in India, prompting the government to develop and implement regulatory frameworks to manage their risks and opportunities. This paper explores the evolution of cryptocurrency regulations in India, comparing them with those in major economies such as the United States, the European Union, and China. It evaluates the impact of these regulations on investor sentiment, market volatility, and illegal activities, offering insights into how regulatory approaches shape the future of India's cryptocurrency market. The paper furthermore examinations the effect of cryptographic money on a singular's position and gives a straightforward picture of its effect on different regulations in India

**Keywords:** Crypto-currency; Regulatory Framework; Investor Sentiment; Market volatility

### 1. Introduction

Cryptocurrencies are beginning to reshuffle the deck chairs of financial markets worldwide, presenting new threats and opportunities for all players. If you look at what the Indian government started off with in terms of regulatory frameworks for cryptos, they were mostly a bit ambiguous and evolved gradually towards being more structured. This paper looks at the approach India is taking with cryptocurrency regulations, examines global norms in contrast and determines how effective these measures are addressing important market challenges. Cryptocurrencies, are digital or virtual assets protected with cryptography. They exist outside the control of banks and by virtue cannot be controlled; they are decentralized making them extremely difficult to regulate (Catalini & Gans, 2016).

This is an exploratory, qualitative research involving secondary data. To achieve above objects a methodical review of literature grounded on bibliographic references and grey literature of preliminarily published work have been conducted. Grey literatures including published documents were linked through electronic hunt using Google Scholar, also other searches were done using referenced works of applicable articles causing snowball effect and also referring to various sources such as newspaper articles, websites, finance reports and World Bank report.

### 2. Evolution of cryptocurrency

Cryptocurrencies first burst into the world's consciousness in 2009, when Bitcoin-the world's first truly decentralized currency-was developed. The core cryptocurrency concept is to develop some sort of safe and anonymous way for person A to send money to person B. Over time, the value has shot through the roof, and it has been touted as 'digital gold' by users and proponents.

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### 3. The Dark Side of Cryptocurrency

In 2022, illicit cryptocurrency transactions amounted to a whopping \$39.6 billion, shedding light on the hidden side of the digital currency area. Despite the risks associated with it, some people got involved in various crime scenarios from cyberterrorism and ransomware to crypto-fantasy scam and illegal betting. Curiosity-driven careers have brought officials to the front lines of endless deception and fraud. One major scandal was ignited in Kerala only recently by the Enforcement Directorate who came to know about a huge fake cryptocurrency scheme. The fraudsters assured the investors on the basis of high yields from Morris Coin which is an imaginary cryptocurrency and thus about 900 people suffered the loss of Rs 1,200 crore. Marketing the scam on WhatsApp, YouTube, and renowned personalities was the common way of victimization. The criminals spent the stolen money on cars, properties, and more cryptography currencies, which turned to be the cause of the arrests.

A remarkable instance was the one concerning Ramesh Sri Krishna who lives in Bengaluru and is more known as Sriki. Initially detained for drug transportation Sriki told that a luxurious life was made possible by hacking into a multitude of web platforms including a crypto exchange. Authorities described him as a ghost without any conventional identification or traceable activity. Sri Krishna Ramesh was a real-life example of the roadblocks faced by investigators who are trying to catch sophisticated criminals who are capable of using technology.

The drug trade was also intertwined with cryptocurrency in a significant scandal involving Raghunath Kumar who was known as the 'LSD King'. Operating from prison, Kumar's network crypto for anonymity and managed drug distribution through gig workers recruited from Amazon, Swiggy, and Zomato. The syndicate which is online in the darknet and on some social media platforms is a modern drug trafficking organization that combines digital and physical crime. The ransomware attacks have reached a new peak which is another serious problem, with a sharp rise in the number of attacks in 2020. The victims paid nearly \$350 million in cryptocurrency for the decryption of their files, which is a 300% increase from the previous year. The major institutions in India including OIL India, SpiceJet, and AIIMS have been the victims of these attacks, which indicates the widespread threat of ransomware in the digital age.

Recently at July 18, 2024: WazirX, one of the biggest cryptocurrency exchanges in India, suffered a major security breach. WazirX, India's largest homegrown virtual currency exchange, saw as much as 50% of its virtual assets valued over \$230 million stolen from one of its key trading wallets by bad actors, though with measures available to prevent such an attack. Consequently, it lost an amount of over INR 1900 crore-approximately 230 million dollars. This incident is very important for the entire cryptocurrency markets, and particularly in India.

These instances are the evidence of a wide spectrum of illegal activities that are made possible by cryptocurrency, thus providing the opportunity for the development of new ideas as well as for the emergence of the risks associated with this type of financial technology. As criminals take advantage of the anonymity and worldwide reach of digital currencies, law enforcement, and regulatory bodies are faced with a continuously increasing task to stay at the same level and protect people, as well as institutions, from financial disasters.

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### 4. Legal status of Cryptocurrency in India

Cryptocurrencies are legal in India. Cryptocurrencies such as Bitcoin, Ethereum, and others are not illegal in India, but they lack clear regulatory guidelines. The Indian government is working on a framework to regulate crypto in India and address associated risks and concerns.

Adding complexity to this landscape is the proposed crypto bill 2021 (Cryptocurrency and Regulation of Official Digital Currency Bill, 2021). But because its future is still unknown, the bill could ban private cryptocurrencies and add even more confusion. Individual speculators can bet on and sell digital assets, but these are not legal tender; hence, they cannot be utilized in normal day-to-day transactions anywhere in the country. There are also a couple of positive signals amidst all the regulatory uncertainty. There has also been acknowledgment by the Indian government of what lies in store with blockchain technology, as underlined by initiatives like the Telangana Web3 Sandbox. Perhaps this is a signal that regulated crypto markets might find their place within an Indian financial system at some point.

However, there is much that cryptocurrency investors in India should be wary about. The notorious volatility of the market, added to the fluidity of the regulatory environment, amplifies the risks. Security breaches and scams remain concerns, further raising the need for heavy security measures across all crypto activities. Whereas many countries have their relatively lucid position regarding the status of cryptocurrency, India falls in a grey area, thereby leaving so many in suspense. Cryptocurrencies, such as Bitcoin and Ethereum among others, do not hold the status of legal tender in

India. While trading and investment in crypto is not illegal, the Indian government has levied a 30% tax on income from the transfer of virtual digital assets and a 1% TDS on transactions above INR 50,000 annually.

The Cryptocurrency Legal Status in India as of Oct 26, 2023: The status is not certain and keeps changing momentum. Currently, no clear-cut legal definition of cryptocurrencies has been done, nor are they considered as a form of legal tender within the country legally. In this case, people can trade and hold crypto assets but cannot be used as legal tender for everyday purchases or transactions. It further complicates things in the already prevailing environment, with the proposed bill entitled Cryptocurrency and Regulation of Official Digital Currency Bill, 2021. Again, the balance of proposed prohibition of private cryptocurrencies is a great uncertainty.

Everyone is on their toes, awaiting the outcome of this bill, which will have a great say in crypto's future in India. This could very well mean a complete ban on private cryptocurrencies if passed, thus leaving the future of the market really uncertain. The Indian crypto landscape is teeming with life, replete with exchanges, blockchain startups, and a committed circle of enthusiasts, despite everything apparently functioning in a state of legal limbo. Of course, one ought to be very careful with respect to the security aspect because crypto markets are notorious for their volatility. On the other hand, the cautious stance on the part of the RBI is a conflicting signal to motions like Web3 Sandbox in Telangana. Such a mixed signal preaches an inner tussle between fostering innovation while controlling risks. Professional financial advice is recommended before engaging in any crypto-related activity.

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## 5. Regulatory Framework of Crypto in India

India, therefore, holds a critical position in the international discussion of crypto, from a perspective of economic power and influence, as its evolving stance is vital both for its own domestic market and as a contributor to the ongoing debate in international crypto regulation. This could be at a time when Indian legal positions on cryptocurrency remain foggy. Well-designed regulation is the execution that creates an environment that covers consumer protection, combats illicit activities, and engenders financial stability—that is, the health of the whole financial ecosystem. That does not stifle innovation but put appropriate frameworks in place. They may also provide supervisory oversight, establish know-your-customer principles, and provide remedies against scams and market manipulation.

They can also envisage stability measures and transparency requirements that will temper the volatile tendencies of crypto markets. Of course, the difficult task lies in getting the appropriate balance between innovation and regulation. Some of the policy decisions adopted by India can be informed by approaches tried out both successfully as well as unsuccessfully across the world. Cryptocurrency regulation in India is not precisely a hindrance to growth but an antecedent for building a sound and responsible future. Such regulation needs to be agile and adaptable and evolve in response to ever-changing technology and market dynamics.

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## 6. Protection against Financial Crime

Benefits go beyond protection to the individual. Unregulated crypto has been an easy conduit for money laundering and financing terrorism. Regulations with AML/CFT may put a squeeze on such activities, allowing working relations between authorities and crypto exchanges. Clear treatment of crypto assets ensures unequal contribution to the national economy and excludes tax avoidance or evasion.

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## 7. Financial Stability

Another very significant area of concern is that of financial stability. Systemic risks of unregulated crypto markets could spill into the broad financial system. Regulations help impose controls on such risks by enforcing capital adequacy requirements and protection of investors. Additionally, the integration of regulated cryptos could increase financial inclusion, thus allowing the unbanked people to access financial services.

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## 8. Innovation and Growth

Clearly defined regulations will shine like a beacon for innovation and growth. It will attract serious business and entrepreneurs, thus heralding a healthy ecosystem in the crypto space. This will place India increasingly ahead of the curve as a competitive player within the global crypto market, encouraging investments and talent in the space of blockchain.

## 9. Early Regulatory Stance

First and foremost, India's regulatory stance was so vague. In April of 2018, a circular issued by the Reserve Bank of India-the country's central bank-prohibited the provision of banking services associated with cryptocurrencies. The circular has thrown crypto companies and investors into stormy weather conditions. RBI, 2018.

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## 10. Current Regulatory Framework

India's current regulatory framework is characterized by:

**Fragmentation:** Separate bodies provide oversight to different areas of cryptocurrency regulation, such as the RBI, the Securities and Exchange Board of India (SEBI), and the Ministry of Finance.

**Regulatory Uncertainty:** The continuous discussions and proposed laws generate a continuously changing environment, which in turn, affects the market stability and also the investment decisions.

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## 11. Comparative Analysis of Cryptocurrency Regulations

United States

The U.S. regulatory approach involves multiple agencies which include the following:

- Securities and Exchange Commission (SEC): The SEC Lorem cryptocurrency considering as security (SEC, 2023).
  - Commodity Futures Trading Commission (CFTC): CFTC regulates cryptocurrency as commodities (CFTC, 2023).
  - Financial Crimes Enforcement Network (FinCEN): FinCEN is responsible for compliance with the AML regulations (FinCEN, 2023).
  - Internal Revenue Service (IRS): IRS is in charge of taxing cryptocurrency transactions in a fair manner (IRS, 2023).
  - Effectiveness: The U.S. framework is an all-rounded one; however, it is quite complicated and at times it might be inconsistent because of the multi-agency approach.
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## 12. European Union

The EU is making steps towards a common regulatory framework with the following:

**Markets in Crypto-Assets (MiCA):** MiCA will provide friendlier and more standardized rules across the EU countries. The regulation is targeted at protecting the investor, maintaining the integrity of the market, and establishing AML (European Commission, 2022).

**Effectiveness:** MiCA intends to unify the regulations across the EU which in return is likely to cut fragmentation and afterwards regulate the market more effectively.

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## 13. China

China Government has become a watch-dog:

**Bans:** The Chinese ban on cryptocurrency trading, ICOs, and mining activities came into effect according to the People's Bank of China, 2021.

**Effectiveness:** China's dictatorships could not suppress the activities of crypto in the country, rather they were shifted to other jurisdictions.

## **14. Challenges of Cryptocurrency Adoption in India**

Though this digital frontier of finance promises huge potential, yet it is not without its challenges. From Regulation to widespread acceptance, as the journey is getting charted in the Indian market, several challenges stare in the face-threatening our attention and caution.

The risks of exploiting these vulnerabilities are so critical in understanding and mitigating them as India navigates the terrain of cryptocurrency adoption. Knowing how to make smart choices and being vigilant guards your financial interests in this digital landscape.

### **14.1. Security Threats**

Security is a key concern in virtual cryptocurrency. Hackers and malicious users can create as much as they want from virtual currency if they break the system and know the method of virtual currency creations, around every nook and cranny, there is a hacker ready to steal your valuable virtual coins or generate fake worthless ones, leaving you to kick yourself for naivety. Caution: avoid seedy sites lest they steal away your digital riches.

### **14.2. Crash Risk**

Unlimited printing of virtual money may sound attractive, but it has even brought some real-world economy dangers. Without regulation, issuance might cause inflation or even a collapse. Before investing in lesser-known coins, one should weigh the potential risks against the siren song of high returns.<sup>4</sup>

### **14.3. Real Money Impact**

So, the expanded use of cryptocurrencies for current purchases begs a broader question: what would be the implications for traditional monetary systems? The virtual and real economies need to balance each other out for stability in both financial worlds.

### **14.4. Gold Farming**

Then there's the allure of gold farming, the process whereby gamers earn virtual currency in one game and then sell it to make real cash. That is a completely unregulated process, and with it comes fraud risks, cautioning you when thinking about spending your hard-earned cash on virtual items.

### **14.5. Unstable Value**

In the mercurial world of virtual communities, the value of their currencies indeed is a good yardstick of their popularity. A loss in the interest of its users equates to devaluation. Diversification, therefore, is a prudent strategy-avoid putting all your financial hopes in one fading virtual basket.

### **14.6. Money Laundering**

It is pseudo-anonymous, hence a field for the big guns. Every different platform mediates the virtual-to-real money exchange, and such platforms increase the chances of money laundering. Choosing reputable ones can save your digital fortunes.

### **14.7. Unknown Identities**

In the case of cryptocurrency transactions, fake accounts add to the headache. Whatever transaction takes place is difficult to trace due to the authentication deficiency. Be wary and practice due diligence in online trades.

### **14.8. Black Market**

With the maturation of gaming platforms, a black market for virtual currency trading has sprung up. In order not to fall into these kinds of risks, it is better to stick to secure and legal ones.

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## **15. Recent Developments**

Particularly recent actions are taking place to formalize and regulate the market:

Taxation: In 2022, The Indian government introduced a 30% profit tax on crypto and a 1% Tax Deducted at Source (TDS) on transactions to legitimize the sector (Finance Act, 2022).

KYC and AML Regulations: Crypto exchanges are bound to follow Know Your Customer (KYC) and Anti-Money Laundering (AML) regulations to increase transparency (Financial Intelligence Unit - India, 2022)

Legislative Efforts: The proposed Cryptocurrency and Regulation of Official Digital Currency Bill aims to be a framework for digital currencies and Central Bank Digital Currencies (CBDCs) (Ministry of Finance, 2022)

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## 16. Conclusion

The Indian cryptocurrency landscape is interesting on many counts, not only because of its own internal complexities but for their effect on the greater global regulatory landscape. In many ways, it embodies both the challenges and opportunities thrown up by new technologies and innovation and most importantly underlines the need for clear responsible regulation in times to come. While cryptocurrency gains momentum in India, a host of challenges are related to unclear rules and issues of security. There are ample opportunities for financial inclusion and easier investments; what is needed at this stage in India is crystallization of rules, education of people, and technological development. Thus, the government is looking toward Web3 and blockchain for innovation. It is a balancing act-come up with newer ideas and proper rules-which would safely and successfully bring in the use of cryptocurrency in India.

### *The way forward*

In other countries such as South Korea, there is a plan of putting in place a statutory framework which will govern the issuance and the use of digital assets and digital currencies. In others, such as India, there is a proposed effective prohibition on the use of digital assets and digital currencies. The Lower House of the Parliament, in its bulletin, issued on January 30, 2021, demonstrates that the Indian parliament has proposed introducing The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 („the”)Ban „private“ Cryptocurrencies like Bitcoin and introduce its own digital currency which is often termed as „Central Bank Digital Currency“ (“CBDC”) like Tunisia’s eDinar launched in 2015, Senegal’s eCFA (2016), Venezuela’s Petromoneda (2018) or the most recent China’s digital Yuan (2020). Some of the other notable jurisdictions that are experimenting with the CBDC, include France, Canada and Sweden. India’s stance of regulating the Cryptocurrency by introducing the state backed digital currency which will be regulated by the RBI is shocking, however it does not come as a surprise as both, the Committees” report of June 2019 and the Draft Bill, Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 were indicative of the same. The approach similar to that of China, also indicates that India acknowledges the potential application of the virtual currency in the future. Since, there wasn’t any sui generis legislation to govern Cryptocurrencies, this Bill will provide clarity as to how it should be regulated, however, uncertainty exists as to (i) what exactly is „private“ Cryptocurrencies, (ii) whether Cryptocurrencies will be treated as a 'currency' or a 'stock' or there will be an outright ban on dealing with them, and (iii) whether there would be any tax mechanism in place to check Crypto trading as of late rumoured in December 2020. The market will be developed in a regulated manner, and India’s regulatory response has been cautious yet progressively more accommodating as the entrants grow.

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## Compliance with ethical standards

### *Disclosure of conflict of interest*

No conflict of interest to be disclosed.

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