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## REGULATION AND COMPLIANCE OF CROSS-BORDER CRYPTOCURRENCY TRANSACTIONS UNDER FEMA

~Shreya Singh

The Foreign Exchange Management Act (hereinafter referred to as FEMA) oversees all cross-border transactions involving foreign exchange. Despite the rapid growth of India's crypto-asset market, the acquisition of these assets is not confined to Indian exchanges alone. Blockchain startups present another method for crypto to traverse borders. Many of these startups raise capital by offering tokens on crypto exchanges, known as initial exchange offerings (hereinafter referred to as IEOs) or initial coin offerings (hereinafter referred to as ICOs). The key difference between them is that IEOs involve exchanges vetting both the issuer and the token project. In contrast, ICOs do not undergo such due diligence, as exchanges might list the token later without facilitating the initial offering.

The location of an asset is a crucial element in foreign exchange management laws, as it helps ascertain whether the asset has crossed borders. Determining the site of crypto-assets is challenging because these assets are intangible and do not physically exist in any single location. In the *RBI v IAMA* case, the Supreme Court highlighted that 'virtual currencies cannot be stored anywhere, in the real sense, as they lack any physical shape or form.'<sup>1</sup>

In the case of *CUB Pty Ltd v Union of India*, the Delhi High Court ruled that the location of intangible assets is the same as that of their owner.<sup>2</sup> The Court concluded that, without clear guidelines under the Income Tax Act, the internationally accepted rule of *mobilia sequuntur personam* should be applied, meaning the situs of an intangible asset is the same as the owner's location.<sup>3</sup> Consequently, the income was not taxable in India. It would be prudent for the

<sup>1</sup> *IAMA vs RBI*, Writ Petition (Civil) No. 528 of 2018.

<sup>2</sup> *CUB PTY Ltd. Vs Union of India*, WP (C) No. 6902/2008.

<sup>3</sup> *ibid*

government to consider adopting this principle to determine the situs of crypto-assets under FEMA and ensure consistency across regulatory frameworks.

According to Section 2(h) of FEMA, "currency" encompasses currency notes, postal notes, postal orders, money orders, cheques, drafts, traveller's cheques, letters of credit, bills of exchange, promissory notes, credit cards, or similar instruments as notified by the Reserve Bank of India (hereinafter referred to as RBI).<sup>4</sup> Since the RBI has not explicitly notified cryptocurrency as a "currency," it cannot be considered as such in India.

Since cryptocurrency cannot be classified as "currency" without an RBI notification, regulating it as a subset of "foreign currency" is irrelevant. Similarly, because cryptocurrency does not constitute "foreign currency," it should also be excluded from the definition of "foreign exchange" under Section 2(n) of FEMA. The RBI's clarification on cryptocurrency's classification within FEMA highlights its distinct status separate from traditional currency and foreign exchange.

There is no explicit classification of virtual currencies under FEMA. The RBI has stated in response to Right to Information requests that it does not categorise virtual currencies as currencies under FEMA, there are no guidelines for virtual currencies under FEMA, and there is no legal prohibition (including under FEMA) on banks facilitating the purchase and sale of virtual currencies and cryptocurrencies. The IAMAI case also acknowledges that the RBI has not classified virtual currencies as currency under FEMA. This is significant because FEMA mandates that all sales and withdrawals of foreign currency must be conducted through an authorised dealer of foreign exchange. Since virtual currencies are not classified as foreign currency, they can be bought and sold through regular business entities or peer-to-peer transactions as is currently done.

There is no legislation regulating cryptocurrencies, nor does the definition of currency under FEMA encompass them. However, cryptocurrencies can be bought, sold, transmitted, transferred, delivered, stored, and possessed. These unique features and the demand for cryptocurrencies for these purposes demonstrate their utility. One could argue that cryptocurrencies might be considered goods under FEMA, but the legislature has yet to make any determination in this regard.

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<sup>4</sup> The Foreign Exchange Management Act, 1999, § 2(h).

Virtual currencies might be considered as goods or software under FEMA, though there is no explicit definition of goods under FEMA. The IMAI case holds that virtual currencies are intangible property that, in certain circumstances, also function as money.<sup>5</sup> This introduces some ambiguity regarding the classification of virtual currencies under FEMA.

If virtual currencies are classified as commodities, operating an exchange to trade them may be regulated as a commodities exchange. This could have implications under India's regulations on inward foreign direct investment, specifically the NDI Rules. In light of the rise of cryptocurrencies, digital payments, and online transactions, there is a pressing need to re-evaluate FEMA's applicability and regulatory oversight. India treats crypto as 'foreign assets' under its FEMA rules. The RBI could regulate crypto exchanges as 'authorised persons' under FEMA, allowing them to deal in foreign currency.

The intersection of cryptocurrency and FEMA is a regulatory challenge that can only be addressed through clarificatory intervention. This could involve creating a sui generis law that not only establishes a comprehensive regulatory framework for the sector but also clarifies capital control aspects for crypto assets. The location of an asset is crucial for applying capital controls, especially for digital assets, where determining the exact location is complex. A new law could adopt the established tax law position that the location of the owner is considered the location of the intangible asset. This would harmonise the principle of situs determination across tax and foreign exchange management laws, providing greater regulatory clarity.

It is crucial to establish clear, precise definitions and detailed guidelines for various transactions, including derivatives, cryptocurrencies, and digital assets. A comprehensive glossary and an official repository of guidelines would serve as a reliable reference for businesses. This approach would ensure accurate interpretation and facilitate adherence to regulatory requirements.

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<sup>5</sup> IMAI vs RBI, Writ Petition (Civil) No. 528 of 2018.