

GST - Bitcoin - Currency or Commodity?

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BITCOIN

is neither fish nor fowl. But both pricing it as a commodity when no commodity exists and trying to make it behave as a currency, seem problematic. The problem is not that it is not issued by the Government nor that it is unregulated. The problem is that it is hard to see what bitcoin really is...

A Rajya Sabha Member asked a question:

whether Government collects GST from cryptocurrency exchanges in India..

On 23.3.2021, the Minister of State, Mr. Anurag Thakur answered:

Supply of any service, if not specifically exempted, is taxable under GST and no service related to cryptocurrency exchange has been exempted. Further, Service Accounting Code (SAC) are headings containing broadly a number of economic activities and there being no specific SAC for cryptocurrencies, the GST collections specific to cryptocurrencies are not available .

On the same day, the minister answered another question, on the threats of private cryptocurrencies such as Bitcoin to Indian economy; whether Bitcoin is traded in the country in clandestine manner and has come to the notice of Government; and if so, the details of steps taken or being taken to curb illegally trading in cryptocurrencies?

The answer was:

RBI has cautioned users, holders and traders in virtual currencies (VCs) including Bitcoins regarding various risks associated in dealing with such VCs through its public notices issued in December 2013, February 2017 and December 2017. Further RBI issued a circular dated April 6, 2018 advising that entities regulated by the RBI shall not deal in VCs or provide services for facilitating any person or entity in dealing with or settling VCs. However, the Hon'ble Supreme Courts vide its judgement dated March 4, 2020 has set aside the circular of RBI. Further, it may be mentioned that it was announced in the Budget Speech for 2018-19 that

"The Government does not consider crypto-currencies legal tender or coin and will take all measures to eliminate use of these crypto-assets in financing illegitimate activities or as part of the payment system. The Government will explore use of block chain technology proactively for ushering in digital economy."

The Story so far:

Probably for the first time RBI took note of technology risks in changing business environment, in their Financial Stability Report of June 2013. Paragraph 3.60 of this report noted that globally, the use of online and mobile technologies was driving the proliferation of virtual currencies. Therefore, the report stated that those developments pose challenges in the form of regulatory, legal and operational risks.

On 24-12-2013, a [Press Release](#)

was issued by RBI cautioning the users, holders and traders of virtual currencies about the potential financial, operational, legal and customer protection and security related risks that they are exposing themselves to. The Press Release noted that the creation, trading or usage of VCs, as a medium of payment is not authorized by any central bank or monetary authority and hence may pose several risks.

On 01-02-2017, RBI again issued a [Press Release](#) cautioning users, holders and traders of virtual currencies,

advising that it has not given any licence/authorisation to any entity / company to operate such schemes or deal with Bitcoin or any virtual currency. As such, any user, holder, investor, trader, etc. dealing with Virtual Currencies will be doing so at their own risk .

On 01-02-2018, the Finance Minister, in his [budget speech](#) said,

Distributed ledger system or the block chain technology allows organization of any chain of records or transactions without the need of intermediaries. The Government does not consider crypto-currencies legal tender or coin and will take all measures to eliminate use of these crypto-assets in financing illegitimate activities or as part of the payment system.

The Government will explore the use of blockchain technology proactively for ushering in digital economy.

RBI issued a [circular](#) on April 6, 2018 stipulating that:

- In view of the associated risks, it has been decided that, with immediate effect, entities regulated by the Reserve Bank shall not deal in VCs or provide services for facilitating any person or entity in dealing with or settling VCs. Such services include maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral, opening accounts of exchanges dealing with them and transfer / receipt of money in accounts relating to purchase/ sale of VCs.
- Regulated entities which already provide such services shall exit the relationship within three months from the date of this circular.

This Circular was set aside by the Supreme Court on 04.03.2020 and nothing really happened after that.

The ***Cryptocurrency and Regulation of Official Digital Currency Bill, 2021***

, was proposed to be introduced in the Budget Session of 2021, but that did not happen. This Bill had a 2018 and 2019 versions which could not make it to Parliament.

But what is this all about?

'Virtual currency' is defined as a digital representation of value that can be traded digitally and functioning as -

- a medium of exchange; and/or
- a unit of account; and/or
- a store of value, but not having a legal tender status.

'Cryptocurrency' is a math-based, decentralised convertible virtual currency protected by cryptography by relying on public and private keys to transfer value from one person to another and signed cryptographically each time it is transferred.

Bitcoin is a decentralized, peer-to-peer virtual currency that is used like money - it can be exchanged for traditional currencies such as the U.S. dollar, or used to purchase goods or services, usually online. Unlike traditional currencies, Bitcoin operates without central authority or banks and is not backed by any government.

Crypto currencies are supposed to be items of inherent value (similar, for instance, to cash or gold) that are designed to enable purchases, sales and other financial transactions. They are intended to provide many of the same functions as long-established currencies such as the U.S. dollar, Euro or Japanese Yen but do not have the backing of a government or other body.

The Supreme Court Judgement observed,

"The archaeological excavations carried out at the (world wide web) sites, reveal that this digital currency civilization is just 12 years old (at the most, 37 years). But these excavations became necessary since virtual currencies, known by different names such as crypto assets, crypto currencies, digital assets, electronic currency, digital currency etc., elude an exact and precise definition, making it impossible to identify them as belonging either to the category of legal tender solely or to the category of commodity/good or stock solely ."

Though the idea of digital cash appears to have been first introduced by David Lee Chaum, an American Computer Scientist and Cryptographer way back in 1983 in a research paper and was actually launched by him in 1990 through a company by name DigiCash, the company filed for bankruptcy in 1998, with DigiCash becoming Digi-crash.

The goal for the virtual currency was:

"What we want is fully anonymous, ultra-low transaction cost, transferable units of exchange. If we get that going, the banks will become the obsolete dinosaurs they deserve to become."

And Bitcoin was born!

Rather than relying on a central bank or company to issue and keep track of the money - as the existing financial system and Chaum's DigiCash did - this system was set up so that every Bitcoin transaction, and the holdings of every user, would be tracked and recorded by the computers of all the people using the digital money, on a communally maintained database that would come to be known as the blockchain.

The process by which all this happened had many layers, and it would take even experts, months to understand how they all worked together. But the basic elements of the system in rough terms by Nathaniel Popper in his book,

Digital Gold: Bitcoin and the Inside Story of the Misfits and Millionaires Trying to Reinvent Money, could perhaps help.

Each user of the system could have one or more public Bitcoin addresses - sort of like bank account numbers - and a private key for each address. The coins attached to a given address could be spent only by a person with the private key corresponding to the address. The private key was slightly different from a traditional password, which has to be kept by some central authority to check that the user is entering the correct password. In Bitcoin, they harnessed the wonders of public-key cryptography to make it possible for a user - he calls her Alice (as cryptographers often did) - to sign off on a transaction, and prove she has the private key, without anyone else ever needing to see or know her private key.

Once Alice signed off on a transaction with her private key she would broadcast it out to all the other computers on the Bitcoin network. Those computers would check that Alice had the coins she was trying to spend. They could do this by consulting the public record of all Bitcoin transactions, which computers on the network kept a copy of. Once the computers confirmed that Alice's address did indeed have the money she was trying to spend, the information about Alice's transaction was recorded in a list of all recent transactions, referred to as a block, on the blockchain.

The result of this complicated process was something that was deceptively simple but never previously possible; a financial network that could create and move money without a central authority. No bank, no credit card company, no regulators. The system was designed so that no one other than the holder of a private key could spend or take the money associated with a particular Bitcoin address. What's more, each user of the system could be confident that, at every moment in time, there would be only one public, unalterable record of what everyone in the system owned. To believe in this, the users didn't have to trust anyone as users of the dollar had to trust the Federal Reserve. They just had to trust their own computers running the Bitcoin software, and the code which was open source and, therefore, available for everyone to review. If the users didn't like something about the rules set down by the software, they could change the rules. People who joined the Bitcoin network were, quite literally, both customers and owners of both the bank and the mint.

And there could never be a demonetisation!

That the Cypherpunks who participated in the initial experiments developed Bitcoin as an alternative to conventional currency, to counter the problems of debasement of currency by central agencies, was made clear when it was said:

The root problem with conventional currency is all the trust that's required to make it work. The Central Bank must be trusted not to debase the currency but the history of fiat currencies is full of breaches of that trust.

What attracted people to this proposal, was the fact that while Central Banks, like RBI, has no restraints in unlimited printing of money, thereby devaluing all savings and holdings, the Bitcoin software had rules to ensure that the process of creating new coins would stop after 21 million were out in the world.

The philosophy is:

Be safe from the unfair monetary policies of the monopolistic Central Banks and the other risks of centralized power over a money supply. The limited inflation of Bitcoin system's money supply is distributed evenly (by CPU power) throughout the network, not monopolized to a banking elite.

One Bitcoin is today valued at more than 28 lakh rupees. But is GST collected? Government has no data!

Until Next Week.