Regulating Virtual Digital Asset

For Prelims: PMLA, VDA, Cryptocurrency, Fiat Currency.

For Mains: Regulating Virtual Digital Asset.

Why in News?

Recently, the Ministry of Finance has extended the Anti-money Laundering provisions to **Virtual Digital Assets (VDA)** businesses and service providers.

- The Ministry has extended the scope of Prevention of Money Laundering Act (PMLA) Act of 2002 by adding the activities related to VDA and Crypto currency under the Act.

How will be VDAs covered under PMLA 2002?

- **Extended Activities:**
  - Exchange between VDA and **Fiat Currencies** (Legal Tender by the Central Government).
  - Exchange between one or more forms of VDAs
  - Transfer of VDAs
  - Safekeeping or administration of VDAs or instruments enabling control over VDAs
  - Participation in and provision of financial services related to an issuer's offer and sale of a VDA
- Now the VDA will have to register as a reporting entity with the **Financial Intelligence Unit-India (FIU-IND).**
  - The FIU-IND performs the same functions as FinCEN in the USA. Under the Finance Ministry, this was set up in 2004 as the nodal agency for receiving, **analyzing and disseminating information relating to suspect financial transactions.**
  - For instance, Reporting entity platforms such as CoinSwitch are now mandated to know your customer, record and monitor all transactions, and report to the FIU-IND as and when any **suspicious activity is detected.**
- **In Line with Global Guidelines:** This risk-mitigation measures is in line with global guidelines put forward by the **International Monetary Fund (IMF)** and the **Financial Action Task Force (FATF).**
  - FATF has a comprehensive definition of Virtual Asset Service Providers (VASPs), an extensive list covering intermediaries, brokers, exchanges, custodians, hedge funds, and even mining pools.
  - Such guidelines acknowledge the role VASPs play in regulating and monitoring the virtual digital assets ecosystem.

What is the Significance of the Move and What are the Concerns?

- **Significance:**
  - Such rules are already applicable to banks, financial institutions and certain intermediaries in the securities and real estate markets.

    - Extending them to virtual digital assets provides virtual digital assets platforms with a **framework to diligently monitor and take actions against malpractices.**
    - A standardization of such norms will go a **long way in making the Indian virtual digital assets sector transparent.**
    - It will also build confidence and assurance in the ecosystem and give the government more oversight on virtual digital asset transactions, which will be a win-win for all.
- **Concerns:**
    - There is a concern that without a central regulator, **VDA entities could end up dealing directly with enforcement agencies, like** ED (Enforcement Director).
    - Owing to current tax regime, many Indian VDA users have already switched from domestic exchanges to foreign counterparts, causing a decrease in tax revenues and transaction traceability. This could also discourage international investors and result in capital outflow.

What are Virtual Digital Assets?

- The government in the **Union Budget for 2022-23** introduced **new provisions aimed at taxing and tracking Virtual Digital Assets.** Along with the framework for taxation, the Budget for the first time defined virtual digital assets.
- It has defined virtual digital assets in the **newly inserted clause (47A) under Section 2 of the Income Tax Act, 1961.**
- VDA has been defined to mean any information or code or number or token (not being Indian currency or any foreign currency), generated through cryptographic means, with the promise or representation of having inherent value.
- VDAs mean cryptocurrencies, DeFi (decentralised finance) and **non-fungible tokens (NFTs).**
- From April 2022, India introduced a **30% income tax on gains made from cryptocurrencies.**
- In July 2022, rules regarding 1% tax deducted at source on cryptocurrency came into effect.

Way Forward

- India should reconsider **its high tax rates on virtual digital assets,** which are currently higher than other asset classes.
- With the new PMLA notification reducing the risks of money laundering and terror financing, there is an **opportunity to align virtual digital assets taxes with other asset classes.**
- Doing so would reduce tax arbitrage, which would help **retain capital, consumers, investments, and talent within the country** and reduce the size of the grey economy for virtual digital assets.
- In Asia, Japan and South Korea have established a framework to licence VASPs, while in Europe, the Markets in Crypto-Assets (MiCA) regulation has been passed by the European Parliament. Going forward, a progressive regulatory framework will instill the animal spirit in India’s innovation economy and establish India’s virtual digital assets leadership.
- Crypto assets are by definition borderless and require international collaboration to prevent regulatory arbitrage. Therefore, any legislation for regulation or for banning can be effective only with **significant international collaboration on the evaluation of the risks** and benefits and evolution of common taxonomy and standards.

Source: TH