DECRYPTING THE CRYPTO WORLD

WHITEPAPER ON MARKET OPPORTUNITIES IN INDIA

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AN INTRODUCTION TO CRYPTO ASSETS

Crypto has emerged as an increasingly interesting space for investors, consumers, entrepreneurs, and regulators. Though similar to any emerging technology, it has its fair share of complexities. As a brief definition, crypto refers to digitally-native assets running on a decentralised peer-to-peer network (also called a blockchain), which publicly validates all transactions occurring on the network. This technology has the potential to transform the entire global economy. It has recently reached an inflection point of consumer adoption, reaching new all-time highs in user and market cap terms. Crypto could be particularly valuable to emerging nations like India, but this will require regulators to develop a thorough understanding of the technology and ultimately to craft thoughtful policies mitigating risks without stifling innovation and growth.

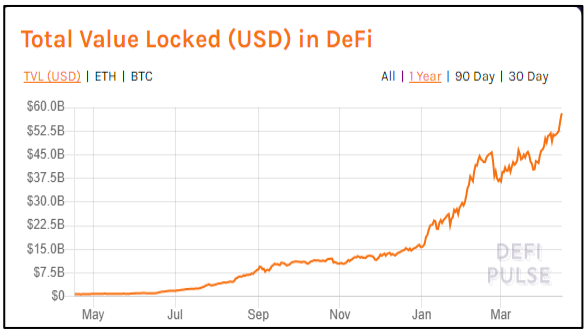
CRYPTO ADOPTION HAS REACHED AN INFLECTION POINT AND WILL HAVE SIGNIFICANT ECONOMIC IMPACT

Bitcoin, invented in 2009, was the first digital crypto asset, but since then, the crypto ecosystem has expanded to include over 5,000 different digital assets and tokens today. While Bitcoin continues to be the best-known and most widely adopted crypto asset, several others (e.g., Ethereum, Tron, Zilliqa, Polkadot, Litecoin, Uniswap, etc.) have gained notable popularity as the number of use cases has expanded dramatically. In recent years, broader public awareness of Bitcoin specifically and blockchain technology generally has sparked accelerating adoption of crypto assets. The global user base increased by 190% between 2018 and 2020 (now having surpassed 200 million) and recently culminating in total crypto market cap reaching an all-time high of $2 trillion in April 2021. It's also worth noting that Coinbase, the most popular US-based crypto exchange, recently listed in the stock market at over $70 billion in market cap.

While Bitcoin has led the popularisation of crypto, owing to its "first-mover" status and a relatively less-speculative store-of-value (i.e. "digital gold"), much of the remarkable adoption has been driven by more novel use cases. These new use cases include money transfer, remittances, trading, lending (collectively known as "DeFi", or decentralised finance), digital art, crowdfunding, and many others. Many real-world industries stand to benefit from maturing blockchain technology and its implications on contracts, logistics, media, cybersecurity, etc.

Total crypto market cap reached >$2T over 5 years[1]

Value of DeFi rose over $50b in 1 year[2]



In terms of forward-looking economic impact, The World Economic Forum (WEF) anticipates that 10% of global GDP will be supported by blockchain by 2025 as one of the most critical technologies[3]. Other economic research suggests blockchain could generate $3 trillion per year in business value by 2034.

[1] Source: https://in.tradingview.com/markets/cryptocurrencies/global-charts/
[2] Source: https://defipulse.com/
[3] NITI Aayog- Blockchain India Strategy

INDIA'S OPPORTUNITY IN CRYPTO

Crypto is a massive opportunity for India, with significant potential to enhance the capabilities of an economy that is already well-suited to attract crypto-related capital investments, considering the market size and internet connectivity. But the opportunities from crypto adoption are about far more than simply attracting FDI, with benefits including enhancing the country's technological skillset, thereby broadening employment opportunities. As mentioned, crypto is one of the fastest-growing technology trends today (if not *the* fastest), which is likely to encourage an upsurge of entrepreneurial activity, carrying with it opportunities for acquiring new skills and innovation.

This wouldn't be the first time India capitalised on emerging trends in technology to benefit business and consumers alike. In the first wave of tech adoption, India became the global hub of IT services, creating more than $250 billion of market cap. In the current wave (consumer internet and SaaS), India is on the verge of creating another $200 billion market cap. Crypto very well may be the third frontier for Indian companies to create significant value over time.

NEED FOR REGULATION OF CRYPTO IN INDIA

However, so far, the country is yet to capitalise on this opportunity. Globally, over $5.5 billion has been invested into blockchain start-ups, but Indian companies have received less than 0.2% of this capital. In contrast, Singapore-based blockchain companies have received more than $744 million in capital investment.

Globally, crypto has often faced scrutiny from regulators, with some fearing it could serve as a supplement to fiat currency. However, it has become clear that crypto's use as a currency is increasingly unlikely (i.e., the term "cryptocurrency" is a misnomer). Instead, crypto can be more accurately thought of as a store-of-value and a distributed development platform. As a result, for the most part, regulators worldwide have since allowed crypto exchanges to flourish. While India has some of the best tech talents in the world, it is not capturing a proportionate share of crypto investment due to less regulatory clarity compared to other countries. But the opportunity remains to regain leadership with clear, thoughtful, and innovation-supportive policies governing the crypto space to the benefit of the Indian economy broadly.

POTENTIAL REGULATORY SOLUTIONS TO RISKS INTRODUCED BY CRYPTO

Innovation naturally carries risk which is furthered by the internet, but well-thought-out regulatory frameworks can serve to mitigate such downsides, enabling society broadly to be the significant net beneficiary of technological progress. While these were real risks to be mindful of, ultimately, the internet has created over $200 billion of value for the Indian economy and has catalysed a vibrant start-up ecosystem.

The same or possibly greater potential is possible with implementing thoughtful, clear policies regarding the crypto industry. India has made progress following the Supreme Court's March 2020 repeal of the RBI's barring digital assets, but as mentioned, the general regulatory approach towards this space remains unclear. Below, we offer our thoughts on key risks for policymakers to bear in mind in contemplating crypto and our suggestions on addressing them best to maximise value creation for all stakeholders in society.

1. **Crypto as an asset, not a currency:** crypto must be understood to refer to digital assets and not as a replacement to the fiat currency. Put another way, crypto is simply an alternative asset class, a store-of-value, and not a medium of exchange or unit of account, as illustrated by usage patterns worldwide, including in countries with more mature consumer adoption of the technology. We can look at regulatory benchmarks globally and permit both asset and utility crypto use cases. However, a few prohibit payment use cases

of crypto (e.g., Indonesia), though again, such use is rare even in countries without these restrictions. Due to the very nature of crypto assets being deflationary, they are not regularly used as a payment instrument since prices fluctuate widely on a day-to-day basis.

2. **Taxation:** today, there is no clear framework for taxing crypto in India. It should be treated similar to other investments and subject to capital gains taxes under the Income Tax Act. However, without a specific, clear tax policy on crypto, it is difficult for consumers to understand the implications of investing in the asset class. The Indian crypto community consists of over 10 million holders with over $1.5 billion of assets, a daily trading volume of $350-500 million, 300+ start-ups, tens of thousands of jobs, and hundreds of millions of dollars in revenue and taxes. Global benchmarks for crypto taxation policies include the following:
    - New Zealand: crypto is treated as property for purposes of income tax legislation. When a person acquires crypto for the purpose of disposal, proceeds from selling it are taxable.
    - Israel: for purposes of income tax and VAT requirements, crypto is viewed by Israel's Tax Authority as an asset and taxed following relevant transaction classifications under the tax laws.
    - Japan: The National Tax Agency (NTA) treats the profit earned from sales of virtual assets, in principle, as miscellaneous income.

3. **Traceability:** one of the concerns related to crypto is that it can potentially provide a channel for money laundering. However, this is one area specifically where the benefits of clear regulation are evident- a proper KYC requirement would allow governmental tracing of any suspicious transactions. Today, exchanges are self-regulating, designing their KYC policies internally. Uniform KYC laws articulated by external regulators would remove significant uncertainty for industry participants and benefit governmental visibility. Further, technologically speaking, such policies would be relatively easy to implement considering the open-source nature of blockchains. KYC at the entry and exit points where crypto is purchased from exchanges ensures that there is always traceability and accountability on those who buy and sell crypto assets.

4. **Environmental concerns:** though beyond the scope of India, which has negligible crypto mining activity, mining does require substantial energy, raising questions on its broader environmental impact. Encouragingly, renewable energy is starting to get more widely used for crypto mining, with a 2020 study by the University of Cambridge[4] indicating that 76% of digital asset miners use renewable power sources.

CONCLUSION

To summarise, crypto represents a transformational shift in technology globally, potentially as big as (or even bigger than) the internet. It offers tremendous economic and social opportunities to India. However, seizing such opportunities will require regulators to craft intelligent and thoughtful policies, mitigating the threats of fraud, money laundering, and tax evasion while avoiding policies that stifle innovation and the economic growth inevitably carried with it. It is essential to act now- global adoption of crypto technology has reached an inflection point, and India risks falling behind other, more crypto-friendly geographies without resolute regulatory action. Given the inherent network effects associated with crypto, countries that get involved early are at a significant advantage over those that participate later.

An outright ban on crypto is a negative outcome, both indirectly encouraging adoption of crypto in illegal markets and directly foregoing one of India's most promising avenues for continuing

[4] Cambridge University's Third Crypto Study

to expand its technological relevance globally. Instead, India needs to recognise crypto tokens as digital assets rather than currencies and clarify policies regarding exchange ownership parameters, KYC, FATF guidance, accounting and reporting standards, regulations, AML, import regulations, suspicious transactions reporting, and other matters. To that end, **IndiaTech.org has proposed a 5-point framework in a subsequent paper on how the Indian government can best regulate crypto while encouraging innovation**.

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