BETTER POLICIES FOR BETTER LIVES

OECD Academy for Tax and Financial Crime Investigation

National Academy of Direct Taxes, Regional Campus, New Delhi

Crypto Assets including AML and Asset Recovery Aspects

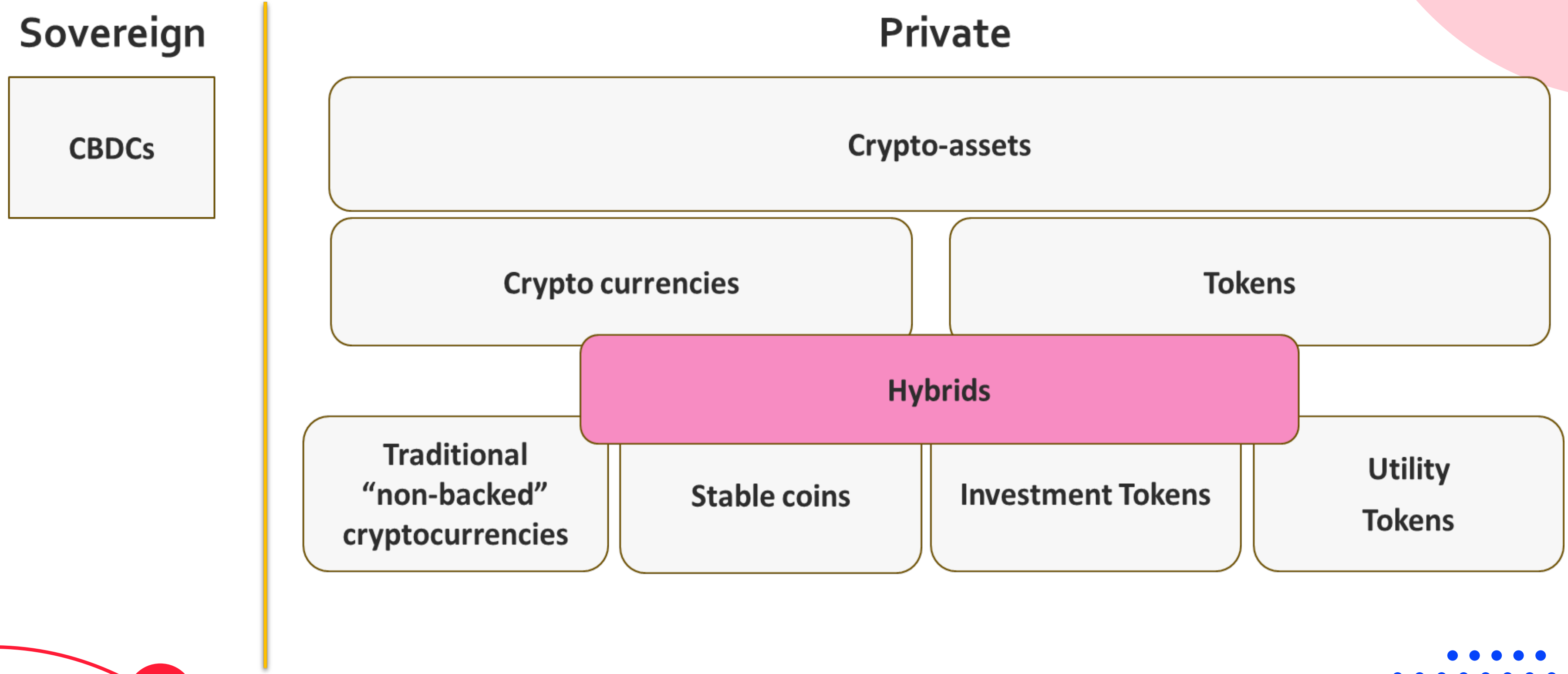
18-27 July,2023

NBCC Plaza, Pushp Vihar, New Delhi

Table of Contents

Crypto Assets

Types of Crypto Assets



Definition of Crypto Assets

- **Financial Action Task Force (FATF) says** *"Virtual assets (crypto assets) refer to any digital representation of value that can be digitally traded, transferred or used for payment. It does not include digital representation of fiat currencies".*

  [FATF Report: Virtual Currencies: Key Definitions and Potential AML/CFT Risks (June 2014)]

- OECD defines Crypto-Assets as " Assets, which can be transferred and held without interacting with traditional financial intermediaries and without any central administrator having full visibility on either the transactions carried out, or the location of Asset holdings"

  [https://www.oecd.org/tax/exchange-of-tax-information/public-consultation-document-crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf]

- As per **Section 2(47A) of Income Tax Act, 1961**, unless the context otherwise requires, the term **"Virtual Digital Asset (VDA)"** means,-

  (a) any information or code or number or token (not being Indian currency or foreign currency), generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and can be transferred, stored or traded electronically;

  (b) a non-fungible token or any other token of similar nature, by whatever name called;

  (c) any other digital asset, as the Central Government may, by notification in the Official Gazette specify

Why Crypto Assets prone to abuse ?

- **Anonymity of Transaction**
- **Easy Convertibility** into fiat currency (Liquidity)
- **Faster Transaction Speed**
- **Global Reach**- truly international with seamless transactions across borders
- **Absence of Uniform Regulation** –scope for shopping around
- **Lower transaction cost**
- **Online Peer-to-peer Transfer** – hard to seize or track the flow of funds
- **No 3rd party Intermediary involved in transaction** –escaping the control of centralized institutions
- **Blurred Taxation Status,** especially across diverse tax jurisdictions

Money Laundering Risks

- Cybercriminals make extensive use of crypto assets, including bitcoin or other VC’s, to make payments for **proceeds of various crimes** such as :

  Arms Trafficking, Kidnapping for Ransom, Crypto-extortion, Bio-terrorism, Sale of Counterfeit fiat currency, Pirated media content and software, Drug Trafficking, Assassination or Hit-men Service, Fraudulent Documents, etc
- Certain VC’s such as **Monero** are specially created to anonymize users.
- **Bitcoin Hawala** is becoming rampant across national borders
- **Ponzi Schemes** through Cloud Mining, ICOs, ETFs, etc have gained popularity.
- **Ransomware attacks** demanding ransom payments in crypto currencies are common.
- Crypto Assets have become medium of exchange for trading on **Dark Web**-(online market place for arms, drugs and other banned items)

Challenges of Crypto Investigations

- **Crypto Asset analysis tools are expensive** and **lack of skilled investigators** well versed with these tools**.**
- **Use of VPN, Tor Browser etc :** Leads to masking of IP addresses of users making real life identities obscure
- **Privacy/anonymity enhancing tools** : Cryptographic "mixers" or "tumblers" to mix crypto-asset funds from different sources to preserve privacy or disguise their origin are tools used to anonymize on-chain activities.
- **Self-hosted wallets (also referred to as "non-custodial", "un-hosted" or "private" wallets) :** Self-hosted wallets are difficult to crack, because the user has substantially more control over their private keys and the crypto-assets.
- **Decentralized exchanges** : Decentralized exchanges (DEXs) operate using smart contracts to allow users to participate in near-instantaneous transactions without a centralized intermediary or custodial third party.
- Crypto transactions spanning across multiple national and tax jurisdictions **require multi-source intelligence.**

Anti-Money Laundering Regulation

Global Regulation of Crypto Assets

Need for Global Collaboration:

- Indian Finance Minister reiterates need For International Collaboration to regulate crypto Space.
- Crypto Assets are relatively new and still evolving.
- Crypto Assets are borderless and require significant international collaboration.
- The borderless nature of the technology, the interconnectedness within the crypto-asset ecosystem and the prospect of linkages with the traditional financial ecosystem strengthen the case for a global approach to crypto-asset regulation.
- The prospect of interconnectedness between traditional financial and crypto-asset ecosystems

Challenges:

- Lack of **Standardized Definitions, Taxonomies, Classifications** and understanding.
- **Regulatory arbitrage**: Global coordination may require countries to develop a consensus or, at the very least, harmonize policy and regulatory frameworks to the extent that this is feasible.
- **Fragmented monitoring, supervision and enforcement:** Monitoring, supervision and enforcement are an essential component of regulatory framework effectiveness. Many jurisdictions around the world have begun to promulgate regulatory frameworks, but most have only just begun enforcement through examination and active supervision.

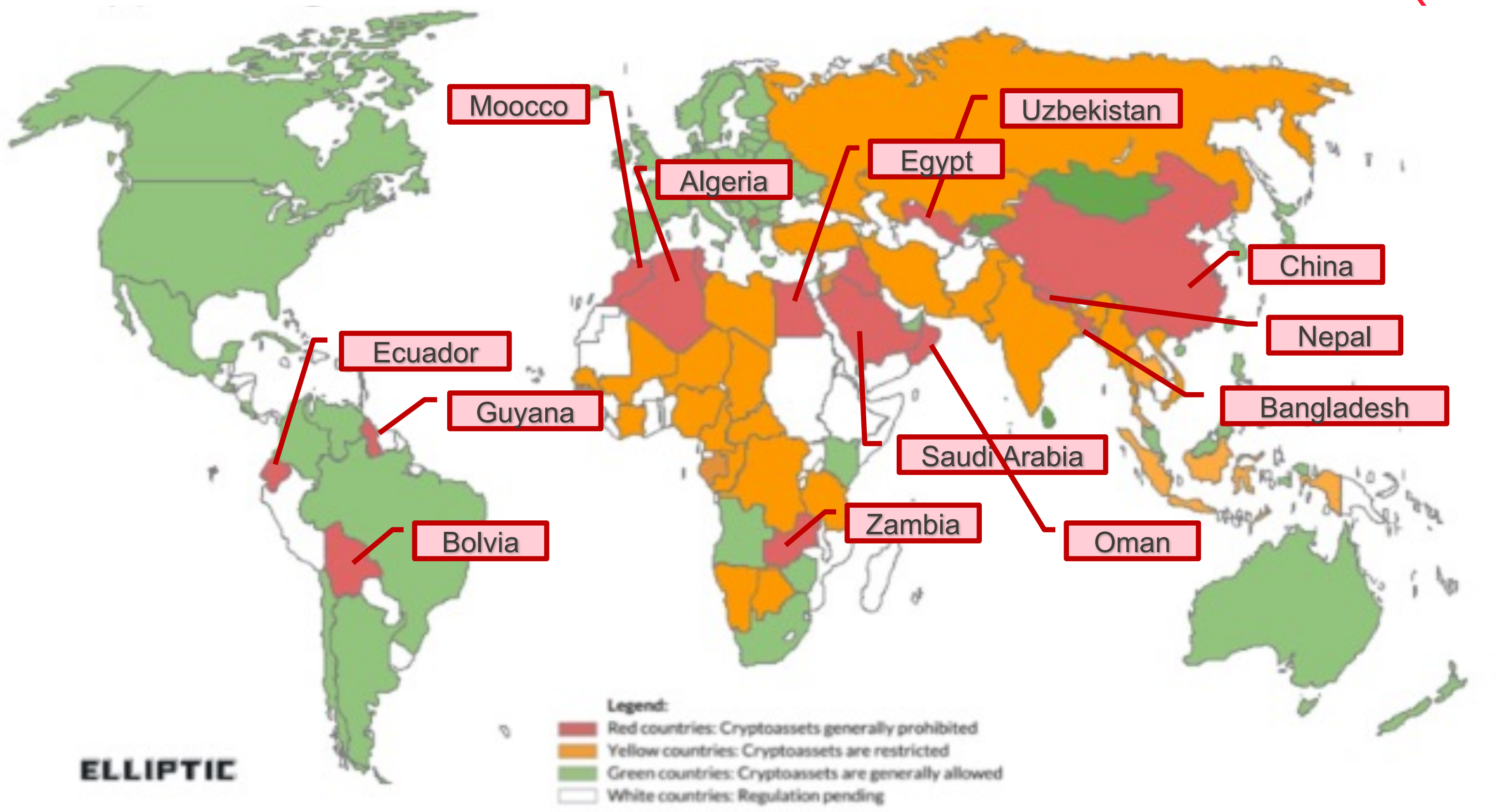
FATF: Need for AML Regulation

FATF in its publication in June 2014 has stated that certain characteristics of virtual currencies, coupled with their global reach, present potential AML/CFT risks, such as:

- The **anonymity** provided by the trade in virtual currencies on the internet
- The **limited identification** and verification of participants
- The **lack of clarity** regarding the **responsibility for AML/CFT compliance, supervision and enforcement** for these transactions that are segmented across several countries
- The **lack of a central oversight body**.

- To restore confidence and public trust in crypto assets in times of **high volatility**.
- To Prevent **market manipulation** and protect investors.
- To help the tax payers make informed decisions on the **potentials, risks**, and advancements associated with block chain technology.
- To prevent **Online frauds and cyber security risks**.
- To prevent **Money laundering of proceeds of crime.**
- To create a **safe and stable marketplace** for all participants as well as to encourage cooperation between governments, regulators and digital asset firms.

Global Regulation Scenario in 2023



Evolution of Crypto Asset Regulation in India

2013 – RBI cautioned users and investors of virtual currencies

2018 – RBI Circular: barred banks and other financial institutions from dealing with crypto currencies

2019 – Finance Ministry Committee on Virtual currencies: recommended banning crypto-currencies in India

2019 – Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019

2020 – Supreme Court Struck down the 2018 RBI Circular

2021 – Cryptocurrency and Regulation of Official Digital Currency Bill, 2021

2022 – Finance Act, 2022 amended Income Tax Act,1961 to define VDA and introduced Taxation regime for Crypto Assets

2023 – VASPs made "Reporting Entities" under PMLA, 2002 and their reporting obligations were defined.

Crypto Taxation Regime in India

Income Tax Act,1961:

- "Virtual Digital Assets" u/s 2(47) of the Income Tax Act,1961 .
- Schedule VDA introduced in ITR for mandatory disclosure of Virtual Digital Asset values held by taxpayers.
- Taxation regime introduced wherein "transfer" of crypto currencies shall be taxed @30 percent
- TDS @ 1 percent was introduced on crypto currency transactions.
- No deduction of expense except cost of aquistion.
- No adjustment of loss or carry forward of loss.
- Mandatory registration and Third party reporting standards u/s 285BA of the Act were made applicable to all financial intermediaries dealing with crypto currencies.

Obligations of VDASPs under PMLA, 2002

Prevention of Money Laundering Act, 2002:
The Ministry of Finance, Department of Finance, on March 7, 2023, issued a notification under the PMLA, 2002, thus bringing the following activities under the ambit of PMLA.

- Exchange between VDA and fiat currencies;
- Exchange between one or more forms of VDA;
- Transfer of VDA;
- Safekeeping or administration of VDA or instruments enabling control over VDA; and
- Participation in and provision of financial services related to an issuer's offer and sale of a virtual digital.

Pursuant to the Notification, any entity facilitating or undertaking the abovementioned activities/transactions, i.e., a VDA service provider ("VDASP"), will now be categorized as a "reporting entity" under the PMLA.

VDASPs are required to comply with additional compliances under PMLA such as the following:

- Verifying the identity of the client
- KYC Reporting
- Ongoing due diligence
- Appointment of principal officer and reporting to Financial Intelligence Unit - India ("FIU-IND")
- Maintaining records maintain records of (a) all transactions (whether attempted or executed) in a manner that enables the statutory authorities to reconstruct individual transactions.

Penalty of Rs 10000/- for each non-compliance, extendable to up to Rs 1 lakh.

CRYPTO-ASSET REPORTING FRAMEWORK (CARF)

- In April 2021, the G20 mandated the OECD to develop a framework providing for the **automatic exchange of tax-relevant information on Crypto-Assets**.
- In August 2022, the OECD approved the Crypto-Asset Reporting Framework (CARF) which provides for the reporting of tax information on transactions in Crypto-Assets in a standardized manner, with a view to automatically exchanging such information.
- The CARF defines the Relevant Crypto-Assets in scope and the intermediaries and other service providers that will be subject to reporting and also incorporates recent developments in the global anti-money laundering standards of the Financial Action Task Force.
- The implementation consists of a **“framework of bilateral or multilateral competent authority agreements or arrangements for the automatic exchange of information** collected under the CARF with jurisdiction(s) of residence of the Crypto-Asset Users, based on relevant tax treaties, tax information exchange agreements, or the Convention on Mutual Administrative Assistance in Tax Matters”.


Crypto Asset Recovery

Crypto Asset Recovery

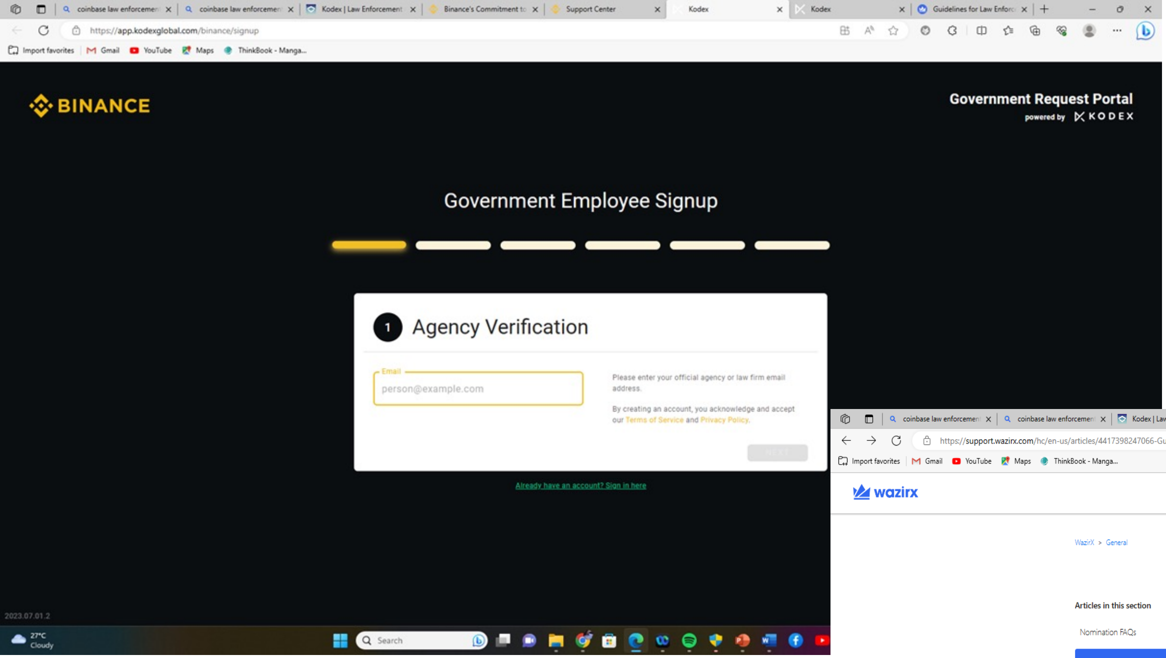
- The **economic opportunity** of Crypto Asset Recovery for Governments is huge and increasing
- Some countries are **recovering astonishing amounts** of virtual assets, which is becoming a major source of revenue.
- USA, Australia, UK, Belgium, France and other EU member states are regularly confiscating and auctioning Crypto Assets.
- Globally, **Governments are tackling Crypto Asset Recovery with existing laws.**
- Compared to recovery of Traditional Assets like immovable property, **recovery of Crypto Assets is more convenient and faster**.
- Few tax jurisdictions have legislated laws to put in place **Statutory and Institutional frameworks for Crypto Asset Seizure & Recovery**.

Challenges

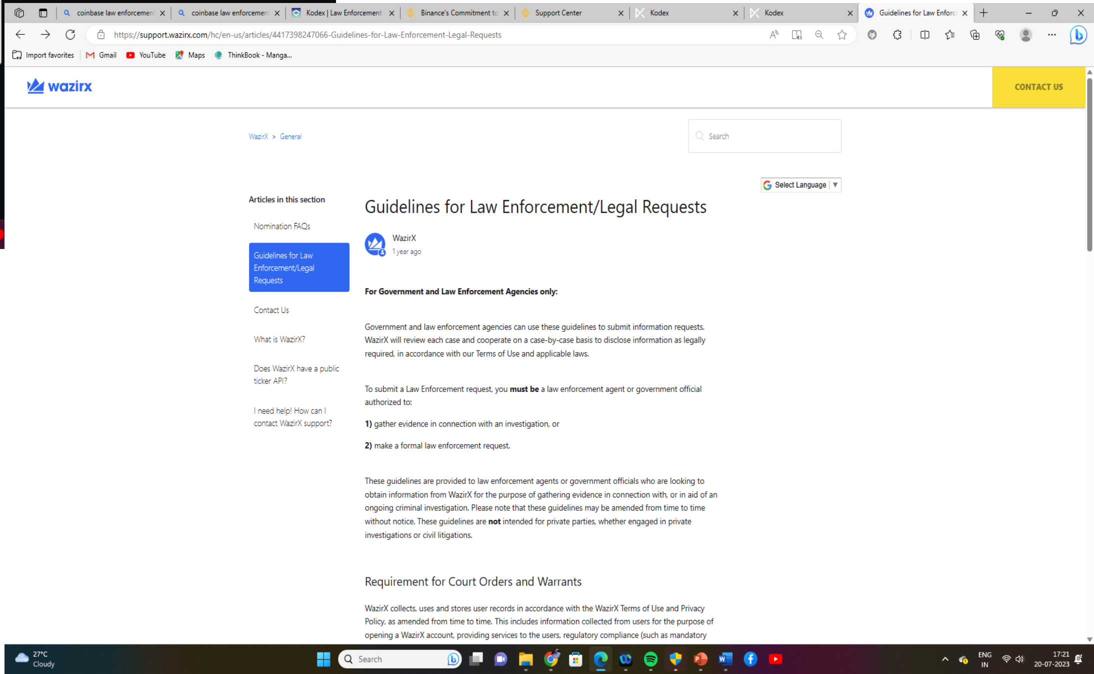
- International Crypto Asset Recovery is **very challenging as formal channels of co-operation can be frustratingly slow and ineffective**.
- **Informal mechanisms** of international co-operation such as the Egmont Group or CARIN network are extremely helpful in obtaining information or supporting efforts to advance an investigation.
- On a positive side, the nature of cryptocurrency means much more can be done virtually, without the need for international cooperation at all. Transactions are recorded on public blockchains accessible from anywhere in the world. Investigating officers can obtain information and evidence by analysing the blockchain from the comfort of their own office.
- Another factor affecting international co-operation for Crypto Asset Recovery is **'Time'.** Virtual assets can change hands around the world multiple times within minutes.
- So **time is of the essence at the freezing stage,** to prevent assets from disappearing or being dissipated while the investigation is underway.

Public-Private Sector Cooperation

- **Virtual Asset Service Providers (VASPs),** such as cryptocurrency exchanges, claim to be self-regulating with AML compliance. They need to be encouraged in supporting law enforcement by bringing in suitable compliance framework such as :
  - VASPs may be mandated to have dedicated departments for dealing with authorities' requests for information and cooperation.
  - VASPs should be mandated to restricting suspects' access to illicit assets upon receiving a foreign court order, rather than waiting for a local order to be issued by the domestic courts.
  - VASPs may be asked to place "soft blocks" on suspect assets, if the requesting law enforcement authority can demonstrate the assets are linked to criminality. This prevents dissipation of Crypto Assets before official freezing orders.
- **Private blockchain analytics** and investigation companies such as Chainalysis, CipherTree and Elliptic are an **essential partner to law enforcement** when it comes to analyzing the blockchain for information and gathering evidence, or developing tools and infrastructure to help them enable more seizures.
- Governments are **engaging specialized service firms** to effectively deal with custody and sale/auction of Crypto Assets.



https://support.wazirx.com/hc/en-us/articles/4417398247066-Guidelines-for-Law-Enforcement-Legal-Requests



https://app.kodexglobal.com/binance/signup

Statutory, Institutional & Regulatory Framework in India

- Income Tax Act, 1961 recognizes Crypto Assets as an asset class, amenable to seizure and recovery, similar to other assets/properties.
- Crypto Assets comes within the ambit of “**Any other valuable article or thing**” mentioned in Section 132 of the Income Tax Act,1961 for seizure.
- Provisions of Section 132(9b) of the Act facilitate Provisional Attachment of Crypto Assets.
- Provisions of Section 281B of the Income Tax Act, 1961 also enable the Assessing Officer to provisionally attach Crypto Assets.
- Prevention of Money Laundering Act, 2002 ("PMLA") brings VASPs within the ambit of the term **"person carrying on designated business or profession“** and imposes certain **obligations on ‘Reporting entity’.**
- **FIU-IND is the nodal agency** for registration of VASPs.
- Seizure of “Crypto Assets” from proceeds of crime by Enforcement Directorate under the provisions of Section 17 of PMLA, 2002.

Thanks!

Do you have any questions?

amitav@incometax.gov.in
+91 9868250668
https://incometaxindia.gov.in/