Article

CS S. Ravishankar
Company Secretary in practice
ASR & CO, Company Secretaries
Senior Associate (Corporate) Jayanth Pattanshetti Associates –
Advocates, Bangalore

Demonetisation of the Currency does the buck stop here

Our Hon'ble Prime Minister Mr.Narendra Modiji may have shocked the nation with his Nov. 8 announcement, the prime minister's move was a master stroke killing many birds in 1 stone (black money, terrorism, hoarding, inflation, banking finance) but the move was hardly unprecedented. India has pulled select denominations of its currency twice before. The first was when Rs 1,000, Rs 5,000, and Rs 10,000 notes were taken out of circulation in January 1946, a year and a half before the country won independence from the British. The Rs.10,000 notes were the largest currency denomination ever printed by the Reserve Bank of India, introduced for the first time in 1938. All three notes were reintroduced in 1954. For the most part, Modiji's measure mirrors Desai's—except this time, the timing was right and the whole episode was kept a secret, and he has the backing of his RBI governor, who applauded Modiji's "very bold step" addressing concerns about the "growing menace of fake Indian currency notes".

Many economists & experts doubt the impact of his decision, because all people don't stack black money only in cash. Rather, they stash it in undisclosed accounts in Swiss Banks, Real Estate & gold," therefore the demonetization may not affect the biggest fish.

In the early '70s, the Wanchoo committee, a direct tax inquiry committee set up by the government, suggested demonetization as a measure to unearth and counter the spread of black money. However, the public nature of the recommendation sparked black money hoarders to act fast and rid themselves of high denominations before the government was able to clamp down on them, this is the reason it was kept a secret this time.

Let us assume for a minute that the demonetisation has helped in eroding the black money and fake currency from the India markets, does the buck stop here??

Modus Operandi for converting black money which was used by many:

1) **Donation to a Temple**: Yes, now is the Time to Donate. People are submitting their Black Money into Temple 'hundis' or donation boxes. Temple Management will show this as Anonymous Donation and exchange it for New Currency notes, keep a Commission for this Service and will return most of it to the Owner.

As per Economic Times Report Dated 20.11.2016, Donations in Tirupati Temple in just 10 days, commencing from November 9, an amount of Rs 30.36 crore was received in the hundi, a figure which was Rs 8 crore more than the same period last year. Mumbai's Siddhi Vinayak has received twice the usual amount in anonymous donations in the week since demonetization.

2) **Pay Advance Salaries**: Yes, In Case you are an Employer then you may pay Advance Salaries to your Employees ranging between 3-8 months. The Modus Operandi adopted in this case is to give employees Salary upto the Limit of Rs.2.5 lakhs i.e. the Limit above which the Deposits would be Examined by the Government.

3) **Finding a Jan Dhan Account holder**: The demonetization of high value currency notes by the Modi government has suddenly made 'money-changers' and 'entry-operators', active in managing black money. Money changers are reported to be using zero balance 'Jan Dhan' accounts, mostly held by BPL families, as a vehicle to convert old currency by depositing Rs 500 and Rs 1,000 notes up to Rs 2.5 lakhs in these accounts.

While the government says it will monitor unusual activity in Jan Dhan accounts, it will be easy for a poor person to say the small amount was his life saving at home.

4) **Purchasing of Gold against a back Dated Invoice**: Gold prices shot up because many black money hoarders rushed to jewellery shops as soon as prime minister Narendra Modi made the demonetisation announcement on 8 November. The Modus Operandi adopted in this case is writing a back dated Invoice i.e. before the Ban and Jewellers charged anywhere between 20 and 65 percent above the going rate by buyers snapping up the precious metal with old notes.

5) **Buying and Cancelling Train Tickets**: People were paying agents for expensive first-class train tickets with old notes and then cancelling them later to get reimbursed in new notes, all in order to get around the tax man.

The numbers of expensive first AC tickets booked per day have increased by many times. As a result, the railways have said refunds won't be in cash. But since these bookings are being made through travel agents, even refunds through electronic transfers mean the travel agent will be able to return large sums in new currency notes.

6) **Making Costly Purchases**: Wealthy Indians rushed to make costly purchases with unaccounted cash soon after Modi's announcement on November 8. Several luxury retailers stocking brands like Rolex and Dior sent emails to clients stating their stores would be open until midnight that day, The Economic Times report.

7) **Find a Money Mule:** Black Money hoarders are reportedly using their staff and Relatives to stash Rs. 2.5 lakhs in their Accounts. Since the Government has said it will not investigate deposit less than 2.5Lacs; this is Relatively Easy way to convert the Currency.

The Next Major Issue are the Crypto / Virtual Currencies or E money

Bitcoin & Etheruem – The Godzillas of uncontrolled money

Bitcoin is a cryptocurrency and a payment system invented by an unidentified programmer, or group of programmers, under the name of Satoshi Nakamoto. Bitcoin was introduced on 31 October 2008 to a cryptography mailing list, and released as open-source software in 2009. There have been various claims and speculation concerning the identity of Nakamoto, none of which are confirmed. The system is peer-to-peer and transactions take place between users directly, without an intermediary. These transactions are verified by network nodes and recorded in a public distributed ledger called the blockchain, which uses bitcoin as its unit of account. Since the system works without a central repository or single administrator, the U.S. Treasury categorizes bitcoin as a decentralized virtual currency. Bitcoin is often called the first cryptocurrency, although prior systems existed and it is more correctly described as the first decentralized digital currency. Bitcoin is the largest of its kind in terms of total market value.

Bitcoin Mining is a record-keeping service. Miners keep the blockchain consistent, complete, and unalterable by repeatedly verifying and collecting newly broadcast bitcoin transactions into a new group of transactions called a block. Each block contains a cryptographic hash of the previous block, using the SHA-256 hashing algorithm, which links it to the previous block thus giving the blockchain its name, all transactions in a common block are grouped into a single transaction identifying the person.

Bitcoins are created as a reward in a competition in which users offer their computing power to establish the order of bitcoin transactions. This activity is referred to as mining and successful miners are rewarded with transaction fees and newly created bitcoins. Miners may also help verify transactions. Besides being obtained by mining, bitcoins can be exchanged for other currencies, products, and services. When sending bitcoins, users can pay an optional transaction fee to the miners. This may expedite the transaction being confirmed. Bitcoin is a form of digital currency, created and held electronically. No one controls it. Bitcoins aren’t printed, like dollars or euros – they’re produced by people, and increasingly businesses, running computers all around the world, using software that solves mathematical problems.

Bitcoin can be used to buy things electronically. In that sense, it's like conventional dollars, euros, or yen, which are also traded digitally. However, bitcoin's most important characteristic, and the thing that makes it different to conventional money, is that it is decentralized.
No single institution controls the bitcoin network. This puts some people at ease, because it means that a large bank can't control their money.

Ethereum on the other hand is a public blockchain-based distributed computing platform, featuring smart contract functionality. It provides a decentralized virtual machine, the Ethereum Virtual Machine (EVM), that can execute peer-to-peer contracts using a cryptocurrency called ether.

The Ethereum platform has multiple proposed uses concerning smart contracts. Bloomberg Businessweek describes it as "shared software that can be used by all but is tamperproof.

Higher-level software can utilize Ethereum to establish an online marketplace platform.

Ethereum is used as a platform for decentralized applications, decentralized autonomous organizations and smart contracts, with "dozens of functioning applications built" on it. The intended scope of applications include projects related to finance, the internet-of-things, farm-to-table produce, electricity sourcing and pricing, and sports betting. Decentralized autonomous organizations may enable a wide range of possible business models that were previously impossible or too costly to run.

Ethereum is also being tested by enterprise software companies for various applications. Previously-established interested parties included Microsoft, IBM, and JPMorgan Chase.

Deloitte and ConsenSys announced plans in 2016 to create a digital bank called Project ConsenSys with ethereums & bit coins.

J.P. Morgan Chase is developing a blockchain, atop Ethereum. The system, dubbed "Quorum," is designed to toe the line between private and public in the realm of shuffling derivatives and payments. The idea is to satisfy regulators who need seamless access to financial goings-on, while protecting the privacy of parties that don't wish to reveal their identities nor the details of their transactions to the general public.

Royal Bank of Scotland has announced that it has built a Clearing and Settlement Mechanism (CSM) based on the Ethereum distributed ledger and smart contract platform. According to a technical paper, "The test results evidenced a throughput of 100 payments per second, with 6 simulated banks, and a single trip mean time of 3 seconds and maximum time of 8 seconds. This is the level appropriate for a national level domestic payments system".

One of the most prominent questions regarding Bitcoins and ethereums is whether use and dealing in these are legal or illegal in India? The legal framework regarding use of Bitcoins and ethereums in India is still evolving. Although there is no clear-cut law pertaining to use of Bitcoins in India yet other laws can be applied to the use and dealing of Bitcoins in India.
For instance, some regulatory guidance regarding Bitcoins can be obtained from the Indian virtual currency schemed issued by RBI. Nevertheless, Bitcoins, their functionality and legality of use in India is still a grey area. The Information Technology Act, 2000 (IT Act 2000) is the cyber law of India that governs the online acts or missions in the Indian cyberspace. The IT Act 2000 prescribes cyber law due diligence in India and the Internet intermediary liability in India. These cyber laws due diligence and Internet Intermediary requirements squarely apply to use of Bitcoins in India.

The regulatory mood in this regard seems to be stringent in nature. For instance, fraudulent multi-level marketing companies' regulation in India is contemplated by Indian government. Similarly, blocking of multi-level marketing (MLM) companies website in India has also been proposed. While regulators are tight-lipped about their plan of action regarding the Bitcoins, a senior official said that one possible way forward can be following the US, where

authorities have decided to subject Bitcoins to money laundering rules applicable to all other financial transactions in the country.

Regulators are also looking into claims being made by some entities of being registered Bitcoin exchange providers, although they might have merely registered as a normal company with the Registrar of Companies with some generic business purposes (not pertaining to Bitcoins).

Indian regulatory and enforcement authorities here are very much concerned about potential money laundering risks emanating from growing use of Bitcoins. To make the things worse, this virtual currency has become the latest tool adopted by fraudsters who are promoting Bitcoins as the next big investment products with unlimited returns. A few complaints have already poured in about Bitcoins being used by some operators in certain new-age and e-versions of multi-level marketing or e ponzi schemes. Regulators fear that this new phenomenon can give rise to a new kind of illegal investment schemes that could be very difficult to track and clamp down.

This is because there is almost zero physical activity when dealing in Bitcoins and nearly all transactions take place in the electronic format.

Being an "open source" product, Bitcoin can be mined by anyone through a complex computer software through solutions shared on an entire network, although the process is complex and such "mining" can be done only on very powerful computers.

Recently a medical website has been offering receiving of Bitcoin payment for medical and surgical abortions in India. Now this may be a controversial and illegal act on the part of the website in question. There could be a potential medico legal violations on the part of the website and even the essential legal formalities regarding establishment of an e-commerce website in India may not have not been complied with.

The Medical Termination of Pregnancy (MTP) Act, 1971 of India clearly states the conditions under which a pregnancy can be ended or aborted, the persons who are qualified to conduct the abortion and the place of implementation. Similarly, the Information Technology Act, 2000 clearly puts Internet intermediary under legal obligations to observe cyber law due diligence in India and Internet intermediary compliance requirements.

India lacks insight and ingenuity when it comes to dealing with novel problems. It always tries to adopt other's plans and efforts to solve its problems. This in many cases bring absurd results. The latest in this series was the issue pertaining to legality of Bitcoins in India. India waited for other nations to take the lead and take a stand before it can regulate or govern Bitcoins in India Meanwhile, China, France, Thailand, etc. have either regulated the use of Bitcoins or they have completely banned them in their jurisdictions. But the Reserve Bank of India (RBI) and Indian government kept on sleeping over the issue. Meanwhile, Bitcoins frauds and crimes are increasing world over, including in India. The Indian approach towards Bitcoins is not at all conducive for national interest and Indian government must urgently regulate Bitcoins in India as soon as possible.

Indian banks are also poor at cyber security implementation and all the strict measure of RBI would fail to achieve the desired objectives. While these measures are still waiting to be implemented by Indian banks, RBI is Exploring Use of Encrypted SMS Based Fund Transfers in India. However, India is not ready for Mobile Governance and the Mobile Payments, Cyber Security in India is needed before implementing such ambitious initiatives.

Regulatory authorities like RBI, Medical Council of India, etc. must clearly specify the use and manner of use of digital currencies like Bitcoins for various purposes. Some regulatory guidance regarding Bitcoins can be obtained from the Indian virtual currency schemes issued by RBI.

Nevertheless, Bitcoins, their functionality and legality of use in India is still a grey area. Hopefully our ever energetic, daring & dynamic PM would do something soon about this menace.