



Anti-Money Laundering Law & Crypto Exchanges: The One Grey Area

Exchanges facilitating trade in virtual digital assets will now be covered under PMLA. But what about foreign domiciled entities?



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Anti-money laundering provisions now stand extended to cryptocurrencies or virtual digital assets. A recent government notification brings INR to crypto and crypto to INR transactions, transfer of virtual digital assets, extending financial services to a sale offer of virtual digital asset etc within the purview of Prevention of Money Laundering Act, 2005.

These activities will now be covered within the definition of “person carrying on designated business or profession” under the PMLA.

Consequently, the exchanges facilitating trade in virtual digital assets will now be treated as a reporting entity under the PMLA. This is a positive step towards re-affirming the legitimisation of trade facilitated by these exchanges.

The Supreme Court’s enabling [judgment](#) in the IAMA case had set aside the Reserve Bank of India’s restrictions on use of banking channels for the sale and purchase of virtual currencies. It had also affirmed

virtual currency exchanges' fundamental right to trade and do business

In spite of this, the enforcement authorities, while investigating into allegations of money laundering, typically would investigate how fiat currency changed hands to virtual digital assets. This has led to freezing of assets on grounds that proceeds of crime have been parked on these exchanges.

As per the government reported data, until March 13, 2023, Rs 953 crores have been frozen by Directorate of Enforcement under the PMLA.

The recent **notification** treats these exchanges on a par with a banking company, financial institution, intermediary, and classifies them as a reporting entity.

The Grey Area

There are several onerous obligations on the reporting entities, such as:

- ◆ Verification of identity by reporting entity, with Aadhar, passport, or other officially valid documents)
- ◆ Maintaining records to reconstruct individual transactions, its nature and value
- ◆ Maintaining record of documents explaining the identity of clients of these exchanges, and beneficial owners as well as account files and business correspondence relating to the clients.

The law requires the reporting entities to examine the ownership and financial position, including source of funds of the client of these exchanges, to record the purpose behind conducting the transaction and the intended nature of the relationship between the transaction parties.

But there is lack of clarity on whether a foreign domiciled entity will be covered as a reporting entity under the notification, especially, if this entity is offering the activities covered within the notification, on the exchange platform accessible by the users in India.

The offence of money laundering typically arises in relation to 'proceeds of crime', which contemplates a scenario where the property can be situated outside India. Even the definition of property is open ended and does not specify that it needs to be within the territorial limits of India. The Principal Officer to be designated to cater to the compliances required as a reporting entity also allows registration of foreigners.

Therefore, a foreign domiciled entity which is offering services covered under the notification, and if such services are accessible to users in India, these entities are likely to be covered as a reporting entity. However, a guidance from the Financial Intelligence Unit (FIU) will assist in bringing more clarity.

The industry has always advocated for regulation and not a ban on trading in virtual digital assets.

The recent notification is a step in the right direction, as it will provide the much-needed clarity to ensure that compliance issues are adequately addressed.

It will also help in bringing transparency in the process as the bad actors will be worried that their transactions will be reported to the authorities by the reporting entities.

The legitimacy of trade offered by these exchanges should also improve the customers' trust and help in attracting institutional capital as the industry matures with time.

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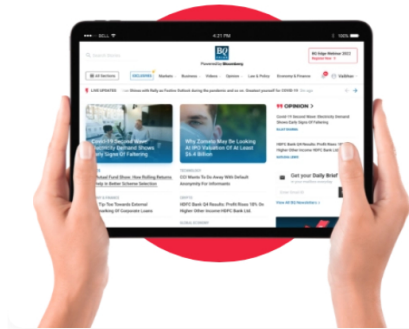


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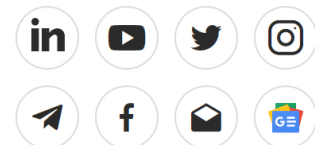
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