

What to know about the mysterious world of cryptocurrencies

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"It's all over, but I still don't get it," said a colleague's wife recently as she scrolled for information on crypto, which has been making waves. She isn't alone, experts say that even some investors don't understand it. Cryptocurrencies, which ballooned during the pandemic, have lost over \$1 trillion in market cap in a couple of months. Bitcoin's value has nearly halved from its November 2021 peak of \$69k. The government was scheduled to present a bill to ban 'private' cryptocurrencies in December — but the matter was left pending. However, that did not stop the finance minister from bringing crypto under the tax net in the latest Budget. Here is a low-down on the highly volatile asset:

What are cryptocurrencies?

Cryptocurrencies are a digital form of money that represent financial freedom and privacy. Unlike traditional currencies, they are not issued by central banks. They also aren't controlled by any individual or institution and are instead governed by a code. They enable secure transactions free from government or corporate influence. Due to encryption, it is not possible to issue counterfeit currency or double-spend.

Why have they become popular?

Cryptocurrencies were born in the wake of the global financial crisis when people were disillusioned with the banking system. Initial backers were those who understood the technology. However, in the pandemic, high liquidity and low interest rates led to demand for riskier assets. Institutional investments and backing by tech billionaires like Elon Musk gave it a boost.

Is crypto investment legal?

In March 2020, the Supreme Court ruled that the RBI's 2018 circular prohibiting banks from facilitating crypto trade was illegal. Currently, it is in a 'grey zone' as there is no legal backing or ban. However, existing laws (like anti-money laundering, cheating) are applicable.

What did the Finance minister announce in the Budget?

FM Nirmala Sitharaman said crypto transactions will be taxed at 30%. The Budget proposed that no deductions will be allowed except cost of acquisition and losses can't be set off against other income. The FM also said taxing an asset does not bring legitimacy.

How can one invest in crypto?

You can open an account with a crypto exchange by submitting KYC details online. The investment process is similar to buying stocks on online platforms.

Why are crypto prices volatile?

Most cryptocurrencies don't have any intrinsic value. Five years ago, the value of 1 Bitcoin was about \$1,000. Now, it is near the \$37,000 level — a rise of 3,600%. However, it has been a rollercoaster ride with many crashes over the years. Demand & supply, competition, and regulation are some factors that determine the value of cryptocurrencies.

If there is no central authority, how is money controlled?

Bitcoin has been designed to have a limit of 21 million and the rate of generation is also pre-decided — the last Bitcoin is set to be mined in the year 2140. Other cryptocurrencies have their own rate of supply. Bitcoin's finite nature has led to it being called an anti-inflation hedge.

Why are regulators wary of crypto?

Crypto threatens state control over monetary policy. Regulators feel private currency will erode public 'trust' in money and lead to financial instability. In India, the RBI has called for a full ban on crypto as partial restrictions won't be effective. Some countries are developing legal frameworks to treat crypto as assets and not modes of payment.

How do payments work and where can one spend crypto?

Crypto payments are enabled by a decentralised computer network, where those who verify the transaction using cryptography are rewarded with tokens. However, avenues to spend crypto are limited. El Salvador is the only country where it has legal tender status. Last year, Tesla had announced it would accept payments in certain cryptocurrencies. The first Bitcoin payment was made to buy pizza in 2010. The bill worth \$40 was paid using 10,000 Bitcoins, which would be worth \$370 million today.

Why do people buy crypto?

Most people are acquiring crypto as an asset and not for payments. They are speculating that it will appreciate as the value of fiat currency deteriorates due to excess supply. Investors see it as a high-risk, high-reward opportunity.

How are payments secure/private?

Traditionally, a trusted third party has facilitated transactions between two people. To remove third-party risks, cryptocurrencies use a trust-less computer network. The identities of the two parties are not disclosed, but their transaction is recorded and verified publicly.

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