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LEGAL FRAMEWORK FOR CRYPTOCURRENCY REGULATION IN INDIA: NAVIGATING THE SHIFT FROM PROHIBITION TO REGULATION – ASEEM SRIVASTAVA

ABSTRACT

The paper of this research analyses the jurisprudential and law making history of the cryptocurrency regulation in India, following the Indian state path of administrative banning of cryptocurrencies to the modern stance of restriction restrictions. The key note judgement in IAMAI v. was made in 2020 by the Supreme Court. In 2026, RBI, India still does not have a comprehensive, independent Crypto-Asset Regulation Act. Rather, the government is putting on a patchwork system of tax and monitor regime, based on the punitive tax capital gain tax of 30 percent under the Income Tax Act and strict compliance with money laundering laws under the Prevention of Money Laundering Act (PMLA). This paper criticises the effectiveness of this de facto system by use of a doctrinal approach to law. The results indicate that, although the existing fiscal and surveillance requirements are effective to reduce short-term macroeconomic risks, they

unintentionally encourage regulatory arbitrage and, fundamentally, do not provide market coherence and protection of retail investors. This paper identifies important gaps in legislation by comparing the domestic policies of India against its own sovereign policies of Central Bank Digital Currency (e-Rupee) programmes and those of other countries, including the MiCA regulation in the EU. In any case, the paper promotes the adoption of a balanced national financial security and technological innovation imperative statutory framework based on nuance and taxonomy.

1: Introduction

1.1 Background

Introduction of the blockchain and the consequent rise and spread of crypto currencies have shaken the old paradigm of finance.[1] Originally existing on the margins of the world financial economy, decentralised digital assets such as Bitcoin and Ethereum now exist in the mainstream with high market value and institutional share. The future of cryptocurrency adoption in India is defined by retail excitement on an unprecedented level and depth of regulatory cynicism. India is uniquely placed in the position where, on the one hand, being one of the largest groups of digital asset owners in the world a huge economic opportunity lies ahead, with, on the other hand, a necessity to balance it with interventions aimed at protecting macroeconomic stability, avoiding capital flight, and deterring illegal financial flows.

[1] Primavera De Filippi & Aaron Wright, Blockchain and the Law: The Rule of Code 15 (2018).

Cryptocurrencies receive a regulatory reaction in India, formally spelled out via the term Virtual Digital Assets (VDAs)[2], which has started as pure enmity to a differentiated and fragmented regime of taxation and surveillance. The reserve bank of India (RBI) has, in 2018, practically banned crypto businesses in the country through a banking ban on the grounds of being a severe systemic risk.[3]

The Supreme Court of India in 2020 in the landmark case of Internet and Mobile Association of India (IAMAI) v. RBI later overturned this ban.[4] Proportionality grounds in the judgement of reserve bank of India. Nonetheless, the judgement instead of leading to the enactment of the comprehensive legislation at a single stroke created the world of legal ambiguity. India has still not managed to have a substantive statute concerning cryptocurrencies as at 2026. As an

[2] The Finance Act, 2022, No. 6, Acts of Parliament, 2022 (India).
[3] Res. Bank of India, Prohibition on Dealing in Virtual Currencies (VCs), RBI/2017-18/154 (Apr. 6, 2018).
[4] Internet and Mobile Association of India v. Reserve Bank of India, (2020) 10 S.C.C. 274 (India).

alternative, the state depends on a tax and monitor system.

Finance Act 2022 has stacked strict taxation under Section 115BBH of income tax Act, requiring obligation of 30 percent tax on the gains incurred due to transfer of VDAs which will be accompanied by 1 percent Tax Deducted at Source (TDS) under Section 194S. Moreover, in 2023, the Ministry of Finance incorporated the service providers of VDA in the framework of the Prevention of Money Laundering Act, 2002 (PMLA), so that they must be registered by the Financial Intelligence Unit-India (FIU-IND).[5] Although these provisions ensure that revenue is generated and the problem of anti-money laundering (AML) is addressed, the issue is that there is no explicit recognition of their legal validity and investors and businesses always remain in the state of regulatory uncertainty.

[5] Ministry of Finance (Dep't of Revenue), Notification No. S.O. 1072(E), The Gazette of India (Mar. 7, 2023).

This research paper examines this complex legal system and how India is surviving the challenging process of moving away to a culture of prohibition and instead adopt a culture of pragmatism.

1.2 Literature Review

1. *Sen, N. (2021). The IAMAI Judgment: A Proportionality Analysis of the RBI's Crypto Ban.* [6]

In her research article on the IAMAI v. Nivedita Sen is a critical constitutional scrutiny of a banking ban by the Reserve Bank of India, 2018. According to Sen, it was an unjustified violation of the basic right to trade as stated in Article 19(1) (g) of the Indian Constitution that this directive by the RBI was in balance. Her main argument in the piece is the inability of the central bank to find any empirical data that can prove real damages caused by cryptocurrency trading to the regulated organisations. Although commending the proportionality test as applied by the Supreme

[6] Nivedita Sen, The IAMAI Judgment: A Proportionality Analysis of the RBI's Crypto Ban, 14 Nat'l L. Sch. India Rev. 112 (2021).

Court, Sen is quite accurate in predicting that the adjudication simply eliminated an administrative bottleneck, as opposed to providing a legal bright line standard of clarity.

2. *Mohanty, N. R. (2023). Taxation of Virtual Digital Assets in India: Law, Policy, and Practice.* [7]

The author of this review N. R. Mohanty thoroughly reviews fiscal architecture as introduced by the Finance Act, 2022. Mohanty is critical on the draconian character of the provisions of Section 115BBH of the Income Tax Act especially the bar on against trading losses against other gains. He assumes that this unequal tax regime along with the 1% Tax Deducted at Source (TDS) of Section 194S was actually created to discourage retail investment and not to create new sustainable revenue. Mohanty presents some of the initial empirical evidence that indicates how these punitive actions unintentionally spurred a mass exodus of capital into untouchable offshore

[7] N. R. Mohanty, Taxation of Virtual Digital Assets in India: Law, Policy, and Practice (2023).

areas and debilitated the entire surveillance agenda of the state.

3. *PwC India (2024). Navigating the Crypto Landscape in India: Compliance, Taxation, and the FIU-IND Regime.* [8]

As this report on the industry indicates, the scholarly emphasis has moved to compliance and anti-money laundering (AML) systems in administration. The report critically examines the notification issued by the Ministry of Finance (2023) according to which Virtual Digital Asset service providers were established as Reporting Entities by the Prevention of Money Laundering Act (PMLA). The authors are about the intensive operational issues, domestic and foreign exchanges can experience in the implementation of the Financial Action Task Force (FATF) Travel Rule and the mandatory registering of the FIU-IND. Although the report argues that such mandates increase the national security of the country and

[8] PwC India, Navigating the Crypto Landscape in India: Compliance, Taxation, and the FIU-IND Regime (2024).

institutionalise reporting standards, they result in prohibitive costs of compliance that disproportionately suppress those starting businesses in Web3 in India.

4. *Alice, M. R. (2025). MiCA vs. The World: Comparative Frameworks in Digital Asset Regulation.*[9]

Alice M. R. offers a strict benchmarking of India fragmented cryptocurrency system against the European Union Markets in Crypto-Assets (MiCA) regulation in her article on comparative law. She points out one of the main contradictions: whereas the EU has been implementing an ex-ante and taxonomy-based licencing system, where consumer protection and market integrity are the key priorities, India is characterised by post-facto fiscal fines and surveillance. Alice writes that the catch-all legal definition of Virtual Digital Assets in India does not make a distinction between utility tokens, stablecoins, and security tokens. Her

[9] Alice M. R., MiCA vs. The World: Comparative Frameworks in Digital Asset Regulation and the G20 Consensus, 45 Harv. Int'l L.J. 310 (2025).

research underscores that without adopting a nuanced, risk-based legislative framework, India will remain a high-risk jurisdiction susceptible to severe regulatory arbitrage.

5. *Sharma, R. (2025). The E-Rupee vs. Decentralized Crypto: Macroeconomic Implications for India.* [10]

The macroeconomic work by Rohan Sharma examines the strategic interaction of sovereign online currency and personal online assets in India. Sharma examines the legal and structural parameters of reserve bank of India pilot programmes of retail Central Bank Digital Currency (CBDC). According to him, the Indian state is actively deploying the e-Rupee in order to be able to preserve monetary sovereignty and to marginalise decentralised options with limiting taxation at the same time. Nevertheless, According to Sharma, market evolution does not involve absolute substitution; as he reports, whereas e-

[10] Rohan Sharma, The E-Rupee vs. Decentralized Crypto: Macroeconomic Implications for India, 38 Econ. & Pol. Wkly. 22 (2025).

Rupee is doing great jobs in enabling frictionless payments, heavily taxed personal cryptocurrencies are still being used as predominant alternative classes of assets.

1.3 Research Gap

Although much of the historical literature on the banking bans and economic effects of the 30% tax rate was found, a significant gap is unmistakable in the legal literature on the existing equilibrium of India crypto framework as of 2026. The vast majority of initial papers predicted the immediate adoption of the Cryptocurrency and regulation of official digital currency bill. Since this all-encompassing bill has been in a continuing state of suspension, the present-day scholarship has not fully been evaluating the way that the patchwork of the Income Tax Act, the PMLA, and FIU-IND compliance serves as a de facto regulatory regime. Moreover, a lack of critical legal examination on the interdependence between the fully operationalized retail CBDC (e-Rupee) of the RBI and the highly regulated market of the

personal cryptocurrency is in place. The gap addressed in this paper is the way to find out how effective is such a fragmentary, regulation-by-enforcement method in comparison with a single statutory framework.

1.4 Research Objectives

The main purpose of this study is to critically examine the current legal processes of cryptocurrencies in India. The specific objectives are:

- To map the jurisprudential and legislative history of cryptocurrency policy in India between the first RBI advisories on cryptocurrencies and the current regulation policy.
- To examine the legal framework of Virtual Digital Assets (VDAs) under the Income Tax Act, 1961, it would be with the 30-percent or capital gains tax implications, and 1-percent Tax Deduction withholding (TD) regime.

- The rationale is to assess the efficacy of Prevention of Money Laundering Act (PMLA) and report by FIU-IND as a deterrent to the dangers of illicit finance in the Indian crypto ecosystem.
- To draw a parallel between the disjointed Indian regulatory process and the emergent international standards, in particular, the MiCA regulation by the EU to draw the areas of legislation lacking.

1.5 Research Questions

In order to fulfil the objectives mentioned above, the following research questions are to be considered in this study:

1. What has been the change of law and judicial interpretation of cryptocurrency in India after Supreme Court decision in IAMAI v. RBI?
2. Is the existing tax system in terms of 115BBH and 194S of the Income Tax Act as an effective regulator or is it simply a punishment to

domestic investors spilling capital to offshore sources?

3. Do the existing rules and regulations governing AML/CFT, as well as the provisional obligatory registration of the Finance information unit, suffice to protect the Indian financial system when there is no specific cryptocurrency regulator?
4. Which legislative provisions should be in the future cryptocurrency legislation in India to transform into a progressive and comprehensive strategy beyond the taxtation and watch control approach?

1.6 Research Methodology

The style of legal research followed in this study is a doctrinal one where analytical and critical analysis of primary and secondary legal sources is greatly used.

- Primary Sources: The paper relies on the major laws that include: Income Tax Act, 1961 (amended by the Finance Act 2022 and later

budgets) and Prevention of Money Laundering Act, 2002. It is a critical examination of the philosophical jurisprudence, especially the Supreme Court ruling in Internet and Mobile Association of India v. Reserve Bank of India (2020). Moreover, the study is based on the executive documents such as RBI circulars, ministry of finance notices and compliance directions of the financial institution supervision.

- Secondary Sources: The study will summarise information and arguments supported by peer-reviewed legal editions, economic scholarly publications, industry documents (e.g., TRM Labs, Chainalysis, PwC), and international systems (e.g., FATF guidelines and the EU MiCA text) to create an extensive contextual analysis.

Another approach that can also be found in the methodology is the comparative approach used in Chapter 4 where India with its fragmented legal status is briefly contrasted with international

regulatory paradigms as a way of benchmarking the effectiveness of the Indian model.

1.7 Scope of Study

This study will have geographical scope limits to the Republic of India. It is limited to the core legislative, judicial and executive systems that regulate individual cryptocurrency and Virtual Digital Assets (VDAs) until March 2026. Although the paper briefly addresses the Central Bank Digital Currency (CBDC) of the RBI to place the issue into context within the wider framework of the digital aspect strategy in the state, the analytical interest is concentrated primarily on decentralised and privated cryptocurrencies (e.g., Bitcoin, Ethereum, stablecoins). Parallel references to the international jurisdictions, including the European Union or the United States, are strictly confined to deliver the benchmarking background on regulatory gaps in India.

1.8 Limitations of Study

The study has a number of limitations inherent to it:

1. Regulatory Volatility: The cryptocurrency industry is extremely volatile. With no enacted complete parliamentary cryptocurrency legislation, the legal legal framework has extensively depended on executive notifications and taxation framework which can at any moment of time be abruptly and unilaterally changed by the Ministry of Finance or the RBI.
2. Absence of Substantive Jurisprudence: Outside the 2020 IAMAI decision, there are few clear Supreme Court precedents in regard to the specifics of smart contracts or decentralised finance (DeFi) or crypto fraud jurisdictional liabilities to analyse with case law.
3. Data Opacity: Cumbersome taxation system has made a large percentage of Indian crypto trading volume start to go into the grey market

or decentralised offshore exchanges (DEXs). Therefore, practical evidence about the actual extent of domestic adoption of cryptos and tax filing can be unfinished and one has to wait until the third-party approximations are received.

2: Evolution of Cryptocurrency Policies and Judicial Interventions in India

The cryptocurrency regulatory stance of the Republic of India is not a steady state, but it has transformed dramatically throughout the last 10 years. It is possible to trace this evolution to an era of benign neglect and primitive warnings to administration of high-handed prohibition, which concluded in a milestone court decision, and eventually came to rest in the present attitude of accommodation unwillingness to concede in favour of a hard-nosed prohibition policy. and appreciating this historical and jurisprudential movement will be critical in providing the context with which the modern legal system of Virtual Digital Assets (VDAs) is governed in India.

2.1 Early Adoption and Initial Regulatory Apprehensions

The origin of the cryptocurrency trade in India dates back to the years 2012 to 2013, when the initial home grown exchanges and an emerging but

quickly expanding group of amateur enthusiasts were formed. This was the early phase on which digital assets existed within a total regulatory vacuum.[11] The decentralised and pseudonymous, as well as the borderless quality of Bitcoin, bypassed the old financial intermediaries controlled by the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI).

The first reaction of the RBI was that of a cautious watching thereafter the regulate by advise strategy.[12] The RBI issued its first press release staff on December 2013, just a few days after the global cryptocurrency market had undergone heavy volatility and been affected by multiple high-profile security breaches (including the insecurities that had been determined at the Mt. Gox exchange).[13] The central bank warned users, holders, and traders of Virtual Currencies (VCs) of the possible financial, operations, legal, customer protection, and security risks of their usage. Most

[11] Andreas M. Antonopoulos, Mastering Bitcoin: Programming the Open Blockchain 12 (3d ed. 2024).
[12] See Siddharth Dalmia v. Union of India, W.P. (C) No. 1071/2017 (Del.) (India).
[13] See Bhanu Pratap v. Union of India, W.P. (Crl.) No. 343/2017 (S.C.) (India).

importantly, the RBI made it clear that VCs had no support on the side of any central bank or monetary authority and therefore their value was purely speculative.

The state rhetoric became more violent as adoptions rose in 2016 and 2017 with the world-wide boom in the Initial Coin Offering (ICO). In February 2017, the RBI repeated its warnings by making it clear that it had not licenced or authorised any body to put in place such schemes nor deal with Bitcoin or any virtual currency. The regulatory fear was the highest in December 2017, as both the RBI and the Ministry of Finance made their stern warnings. The Ministry of Finance provided a specific comparison of cryptocurrencies with Ponzi schemes pointing out that cryptocurrencies had no intrinsic value, and were vulnerable to market manipulation, money laundering and financing of terrorists.[14] Nevertheless, at this time, such statements were

[14] Inter-Ministerial Comm., Gov't of India, Report of the Committee to Propose Specific Actions to be Taken in Relation to Virtual Currencies 12 (2019).

merely of an advisory nature; there was no legal ban in the form of a statute or even an administrative regulation on the rights of a citizen to own or trade digital assets.

2.2 The RBI Circular of 2018: The De Facto Banking Ban

The regulatory environment changed the world on April 6, 2018. The RBI switched on the mode of issuing advisory warnings to proactive administrative measures, and issued a circular named Prohibition on dealing in Virtual Currencies (VCs). [15]The central bank efficiently crafted a de-facto prohibition of the local cryptocurrency sector employing its immense statutory authority under the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949, and the Payment and Settlement Systems Act, 2007.[16]

The 2018 Circular failed to criminalise the possession of cryptocurrencies explicitly which would have necessitated an act of parliament.

[15] Res. Bank of India, supra note 3.
[16] The Reserve Bank of India Act, 1934, No. 2, Acts of Parliament, 1934 (India).

Rather, it focused on the strategic points of the ecosystem that were the fiat-to-crypto gateways. The order required that any person or institution that falls within the jurisdiction of the RBI such as the banks of both the public and the private sector, non-banking financial institutions (NBFCs), and companies offering payment systems could not offer any services to persons or business entities dealing or paying on VCs. Moreover, the circular required the regulated entities, that were already offering such services, to leave such a relationship within three months.

The short term effect of this ring-fencing plan was catastrophic to the domestic digital asset sector. Cutting off the link to the formal banking system, cryptocurrency exchanges in India were left unable to send amount of Indian Rupee (INR) deposits and withdrawals to its users. The domestic markets became dry within a short time and several known large exchanges were forced to cease their operations forever or take their headquarters to the offshore locations with crypto-friendly laws.

Although the RBI explained that the circular was taken as a precaution to ensure that the financial system is not at risk of systemic risks, and capital flight, as well as, undermined monetary sovereignty, the industry saw the move as an existential threat and a denial of their constitutional right to do business.[17] This opposition was only bound to turn the battlefield out of the regulatory sphere into the constitutional courts.

2.3 Internet and Mobile Association of India (IAMAI) v. RBI

The Circular of RBI issued in 2018 has precipitated direct challenges in court, and the case of Internet and Mobile Association of India (IAMAI) v. RBI was a landmark in India.[18] The circular was challenged in the writ petitions filed by Article 32 of the Constitution of India as it infringed the Articles 19(1)(g) (due fundamental right to practice any profession, or to conduct any

[17] India Const. art. 19, cl. 1(g).
[18] Internet and Mobile Association of India v. Reserve Bank of India, (2020) 10 S.C.C. 274 (India).

occupation, trade, or business) and 14 (due fundamental right to equality).[19]

The RBI in defence of their order said that cryptocurrencies by their very nature did not have the qualities of legal tender and presented a dire threat to the structure of payments and clearing systems, which the central bank was required by law to protect. The RBI continued to argue that decentralisation of VCs was a negative situation since the central bank could not monitor money supply, which jeopardised macroeconomic stability.[20]

On March 4, 2020, the Supreme Court produced a subtextual, 180 page decision that handed down a verdict on three judges. On the first instance, the Court confirmed that the RBI had the statutory authority and that the central bank is given the necessary power to control or ban activities that threatened the financial system, although the instruments at issue were not necessarily in strict

[19] India Const. art. 14.
[20] Internet and Mobile Association of India, (2020) 10 S.C.C. 274, 305.

terms considered as currency or money. The Court respected the RBI in terms of macroeconomic governance of the country.

Nonetheless, the Court ended up invalidating the 2018 Circular on the doctrines of proportionality. Using the four pronged test of proportionality as applied in the past jurisprudence, the Court scrutinised whether the absolute prohibition of RBI was the least restrictive action the bank could exercise to reach its goals. The Supreme Court observed a critical evidentiary gap in the RBI's defense: the central bank could not demonstrate any empirical evidence that its regulated entities (the banks) had suffered any actual loss or adverse effect directly resulting from the activities of VC exchanges.

Secondly, the Court observed that other regulatory bodies worldwide and other models of the country attempted to regulate the space, the RBI adopted the radical option of cutting off banking services completely. It was held that, "even though we have

approved... power of RBI to act pre-emptively, we are in this section of the order testing proportionality of such action, in the determination of which RBI must demonstrating at least some semblance of demonstrating damage to its regulated entities. But there is none..."[21]

As a result, the circular was disproportionate and put aside. This historic decision helped to revive the Indian crypto market giving the banking obstacle a blind eye and it triggered a colossal growth in local trades, especially as it meshed with the world bull market of 20202021. Nevertheless, it is essential to mention that the Supreme Court did not legalise cryptocurrency; it just struck down an unwarranted administrative measure not in disproportionate measures, leaving a legislative gap that would be filled.

[21] Id. at 310.

2.4 The Drafting Phase: From Proposed Prohibition to Pragmatic Shift

Alongside the courts, the state machine was trying to devise a legislative solution to the cryptocurrency phenomenon. In 2017, the Ministry of Finance was an Inter-Ministerial Committee (IMC) under the chairmanship of Subhash Chandra Garg who was then the Secretary of the Department of Economic Affairs, to examine the problems surrounding VCs and recommend certain measures.[22]

In 2019, the IMC released its report with an extremely hard-line position. It advised an outright prohibition of any Indian cryptocurrency privately. Along with the report was a draught bill, which is named as the Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019.[23] This was a draconian draught bill that suggested to criminalise the carrying on of any activity that was related to cryptocurrencies such as mining,

[22] Inter-Ministerial Comm., supra note 14, at 14.
[23] Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 (Draft Bill, India).

possession, sale, issue, transfer or use of cryptocurrencies as a medium of exchange and as a store of value. It dictated tough punishment, such as no-bailable escape up to 10 years in prison in case of violation. At the same time, the bill defined the establishment of a digital rupee that will be issued by the RBI, which makes the state preferences toward sovereign-based digital assets more apparent than the alternatives, which are privately owned and decentralised.

The industry was in a panic following the introduction of the draught bill 2019 which was introduced to Parliament but never reached any official stage. The legislative confusion still lasted until late 2021, when a similarly named bill, "The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021" was introduced to the Winter Session of Parliament.[24] According to the official bulletin, the bill aimed at developing a facilitative framework of creation of the official digital

[24] The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 (Unintroduced, India).

currency but outlawed all individual cryptocurrencies in India with some exceptions to enable use of the technology behind them.

Caution was agained by refusing to introduce this bill. This indecisiveness acted as a turning point in the policy of the Indian government. Conceding to the fact that the world is moving to global consensus and tech-wise, blockchain could never be used as an enforceable ban against sovereign countries on anything that exists beyond the borders, policymakers realised that in this scenario, a unilateral ban on the borderless digital assets would be virtually unfeasible, and would tend to push the industry into the world of the underground economy, creating even more risks in terms of money laundering and capital flight.

The state shifted its approach to a pragmatically restrictive but practical way of tax and monitor, rather than finding a statutory ban. Having realised that the prohibition cannot be done, the government determined the direction that would

focus on revenue recognition, transactions, and systemic risk reduction using the means of the available system of financial devices. This policy change provided the foundation to the restrictive taxation framework and Anti-Money Laundering (AML) compatibilities that characterise the current regulatory environment in India to change the legal discussion surrounding the question of existence into instruments of control.

3: The Current Legal, Taxation, and Compliance Framework

After the Indian government attempted to ban decentralised technologies by declaring these technologies illegal in all their forms and in every instance, the Supreme Court struck down the Reserve Bank of India's ban on banking in 2020, prompting the government to discover that such an outright prohibition was futile and economically unsafe to enact. Thus, the situation shifted to a paradigm of regulation through deterrence and surveillance. By the year 2026, there is yet to come an applicable, full-fledged statutory law with regard to the cryptocurrency ecosystem within India. Without it, a rudimentary, but still operative, regulatory framework has been created by introducing alterations in the current fiscal and penal laws. This chapter provides a critical assessment of such a de facto regulatory regime which is largely based on the Income Tax Act, 1961 and the Prevention of Money Laundering Act,

2002 (PMLA) with reference to its interaction to allied administrative guidelines.

3.1 Statutory Definition and Legal Status of VDAs

It was mandatory in law that cryptocurrencies be defined, before the state could tax or even regulate them. The government even evaded the words cryptocurrency or virtual Currency which suggests legal tender or governmental support. The Finance Act, 2022, in turn, inserted the nomenclature name of Virtual Digital Asset (VDA) as Section 2(47A) in the Income Tax Act, 1961. [25]

Section 2(47A) is both technologically non-specific and is broad in definition. It presents a VDA as any information, code, number, or token (not being Indian currency or foreign currency) created or created using cryptographic tools or not, which gives a digital expression of value transacted with or without consideration.[26] More importantly, this definition does not just apply to fungible

[25] The Income-tax Act, 1961, § 2(47A), No. 43, Acts of Parliament, 1961 (India).
[26] Id.

cryptocurrencies, such as Bitcoin and Ethereum, but also Non-Fungible Tokens (NFTs) and any other such kind of token.

But the other important distinction is between fiscal definition and legal legitimacy. A simple inclusion of Section 2(47A) only admits that VDAs is an asset category that is capable of producing taxable income, but not as a recognised legal property or lawful medium of exchange in the Sale of Goods Act, 1930, or the Payment and Settlement Systems Act, 2007.[27] The government has restated several times in parliament answers that taxation of VDAs is not tantamount to legalising them. Also, the definition specifically leaves out the Central Bank Digital Currency (CBDC) the digital Rupee of RBI, which qualifies and is treated as the same fiat money and therefore forms a brick-a-brick legal reality between digital sovereign money and digital private wealth.

[27] The Payment and Settlement Systems Act, 2007, No. 51, Acts of Parliament, 2007 (India).

3.2 The Punitive Taxation Regime: Revenue Over Facilitation

The taxation policy is the most notable feature of the existing cryptocurrency regime in India and this is implemented through the Finance Act, 2022. These provisions were not meant to facilitate the market, but were the motive of the legislation to discourage the speculative retail trading and at the same time collect tax income on an untaxable parallel economy.

3.2.1 Section 115BBH: The 30% Capital Gains Tax

Section 115BBH of the Income Tax Act treats the income obtained in a transfer of a VDA as taxable at a flat rate of 30- percent with no reference to any other surcharges and cess.[28] Legally and economically, this puts VDAs in the topmost tax regime of speculative income of lottery, gambling, or game show under Section 115BB.[29]

[28] The Income-tax Act, 1961, § 115BBH.
[29] Id. § 115BB.

The most controversial and legally inhibited issue with the Section 115BBH is its asymmetry in terms of losses. The fact is clearly stated in the statute that no loss due to the transfer of VDA should be set-off with any other income. Moreover, it does not allow the offsetting of the losses of one VDA against gains of another VDA[30]. As an illustration, when an investor generates gains on Bitcoin but losses on Ethereum, he or she has to pay taxes of 30 percent on the Bitcoin gains without subtracting the losses on Ethereum. Also, there is no deduction of any expenditure (including costs of mining or the cost of servers) or allowance, except the direct cost of acquisition. This harsh clause is akin to treating all profitable VDA transactions individually and as such, it severely suppresses the active trading and market-making liquidity.

3.2.2 Section 194S: Tax Deducted at Source (TDS) as a Surveillance Tool

[30] Id. § 115BBH(2)(b).

To achieve this, the government added Section 194S, which states that Tax Deducted at Source (TDS) on payment of consideration to transfer a VDA will be 1% to have a compliant transactional trail.[31] When a transaction is done on a centralised exchange, the legal obligation of deducting this 1% and paying it to the government is charged on the exchange.

Although the 1% TDS by the government was seen as a tool to monitor the amount of crypto investors, its actual effects over the years and until 2026 is an immense market distortion. Since the TDS would be applied on the full value of the transaction (and not only the capital gain) and since a unit trade is subject to the TDS, high-frequency traders and institutional market makers were essentially made to leave the Indian market. This resulted in a huge, thoroughly-documented capital flight, with Indian users transferring the holdings to decentralised exchanges (DEXs) or non-compliant offshore platforms, ironically

[31] Id. § 194S.

carrying out the main goal of the government to have the ecosystem subjectively monitored.[32]

3.3 Anti-Money Laundering (AML) and Counter-Terrorism Financing (CFT) Framework

The Income Tax Act was used to deal with revenue, but the systemic risks of illegal finance were dealt with through the use of the Prevention of Money Laundering Act, 2002 (PMLA).[33] The government has also subjected VDA service providers, such as exchanges, custodians and wallet providers, to the PMLA, in a watershed notification issued in March 2023.

3.3.1 Designation as Reporting Entities

Through the categorisation of crypto-businesses as a Reporting Entity under the PMLA, the state placed tough, bank-like compliance requirements on crypto-businesses. The VDA service providers that are within India are now by the law obliged to:

[32] Chainalysis, The 2025 Geography of Cryptocurrency Report: Global Adoption and Illicit Finance Trends 42 (2025).
[33] The Prevention of Money-Laundering Act, 2002, No. 15, Acts of Parliament, 2003 (India).

1. Strict Know Your Customer (KYC) and Enhanced Due Diligence (EDD) processes prior to the onboarding of users.
2. Keep detailed account of all transactions at least of five years.
3. Proactively detect and handover Suspicious Transaction Reports (STRs) and Cash Transaction Reports (CTRs) to the Financial Intelligence Unit-India (FIU-IND).[34]

3.3.2 FIU-IND Registration and Extraterritorial Enforcement

In the PMLA notification, any party involved in VDA transfers was required to be registered with FIU-IND.[35] Importantly, this need has been crafted in extraterritorial manner, which means that the requirement is not previously limited to exchanges that are incorporated within the country, as it also addresses offshore exchanges that serve residents of India.

[34] Ministry of Finance, supra note 5.
[35] Id.

This framework was put to trial to a great degree between late 2023 and 2025. In a case where a number of the large offshore interchanges have failed to satisfy the requirements of the FIU-IND registration and report, the Ministry of Finance launched a vigorous enforcement effort. Based on the Information Technology Act, 2000, the government instructed them to block uniform resource locators (URLs) and delete mobile apps of non conforming foreign currencies in domestic application shops.[36] This regulation through enforcement made large international participants retroactively become registered in FIU-IND, pay significant fines in case of non-compliance in the past, and become part of the AML infrastructure in India by 2025. This integration likewise required adherence to the Financial Action Task Force (FATF) Travel Rule that requires exchanges to

[36] Press Info. Bureau, Ministry of Fin., FIU-IND Issues Show Cause Notices to 9 Offshore Virtual Digital Assets Service Providers (VDA SPs) (Dec. 28, 2023), https://pib.gov.in/PressReleasePage.aspx?PRID=1991372.

gather and exchange originator and beneficiary information on crypto transactions.[37]

3.4 Interplay with Existing Administrative and Commercial Laws

The malignant character of the contemporary regime implies that VDA dispenser vendors are obliged to walk through the mazes of mutual legislations, likely to routine jurisdictional conflicts and compliance hassles.

3.4.1 The Foreign Exchange Management Act, 1999 (FEMA)

The extension of FEMA to cryptocurrencies is one of the most legally unclear places in 2026. The fact that VDAs are not a fixed border implies that acquiring crypto with a foreign distributor or relocating it overseas hypothetically involves the foreign exchange laws. The RBI has not categorically defined the category as to whether the transfers based on cross-border crypto transfer

[37] Fin. Action Task Force, Targeted Update on Implementation of the FATF Standards on Virtual Assets and Virtual Asset Service Providers 15 (2024).

on the capital account under fema or as a current account transaction. Nonetheless, the use of the Liberalised Remittances Scheme (LRS) maximum on the acquisition of the VDAs on foreign exchanges is fiercely subject to questioning, and illegal outbound remittance through the crypto medium is systematically examined by the Enforcement Directorate (ED) as an infringement of FEMA.[38]

3.4.2 Consumer Protection and Advertising Standards

In the bull run of 2021, aggressive and misleading promotion by crypto exchanges resulted in regulatory reaction. In retaliation, the Advertising Standards Council of India (ASCI) supported by the Central Consumer Protection Authority (CCPA) of the Consumer Protection Act, 2019, has made stringent requirements in VDA advertising. The regulatory approach requires any form of advertisement related to crypto to include a clear,

[38] The Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999 (India).

standardised, and published statement to the effect of crypto products and NFTs being unregulated and therefore potentially very risky. The loss regarding such transactions may have no regulatory recourse. More so, the law itself does not allow advertisements to reference crypto assets to the existing class of assets that are regulated by law and promise future profits, creating a very low threshold on consumer protection against predatory advertising.

3.4.3 Information Technology Act, 2000 and CERT-In Guidelines

Lastly, the VDAs cybersecurity and data retention fall within the IT Act. Section 70B of the IT Act under which the Indian Computer Emergency Response Team (CERT-In) acted under gave controversial instructions instructing all virtual asset providers, providers of virtual private net (VPN), as well as data centres, to keep comprehensive customer logs and records of

transactions over a transition of five years.[39] These guidelines are geared towards supporting investigation of cybercrime, which requires the reporting of any games of cybersecurity (including smart contract vulnerabilities or wallet hacks) within a strict six-hour timeframe. Even though the provisions have strengthened the national security, they have raised very high legal controversies on the issue of data privacy and the right to autonomy of information as stipulated by Article 21 of the Constitution.

Overall, Chapter 3 demonstrates that India does not have a formal Cryptocurrency Act but is not a jurisdiction that is unregulated. The state has built an effective perimeter defence through the punitive austerities of the Income Tax Act and the stringent surveillance requirements of the PMLA and other similar legislations. Nevertheless, this framework is essentially reactive the tax and trace

[39] Indian Computer Emergency Response Team (CERT-In), Directions under Section 70B of the Information Technology Act, 2000, No. 20(3)/2022-CERT-In (Apr. 28, 2022).

framework not to create innovation, nor to create substantive property rights (in digital assets).

4: Regulatory Challenges and Comparative Perspectives

Although the present regime in India, that is tax and monitor, has been effective in setting up a rudimentary circling barrier against illegal financial outflows, it is very fundamentally incomplete as was based on the Income Tax Act, 1961, and the Prevention of Money Laundering Act, 2002 (PMLA). The state has created a significant form of jurisprudential gap by viewing Virtual Digital Assets (VDAs) more as the tax and surveillance object instead of acknowledging them as a separate financial or technological point in the asset portfolio.[40] This chapter critically evaluates these unresolved legal issues, evaluates the sovereign alternative of the state that is the Central Bank Digital Currency (CBDC) and contextualises the fragmented strategy of the Indian against the emerging global regulatory frameworks.

[40] N. R. Mohanty, supra note 7, at 88.

4.1 Unresolved Legal Challenges and Regulatory Arbitrage

The deficit of an overarching, sovereign Crypto-Asset Regulation Act has brought about a precarious legal setting in which there is extensive information asymmetry, and legal cause and effect tension, along with the extremely important shortage of institutional regulation.

4.1.1 The Void in Investor Protection and Market Integrity

At present, no statutory institution in India including the Securities and Exchange Board of India (SEBI) or even the Reserve Bank of India (RBI) has been clearly given powers by Parliament to be able to regulate the domestic cryptocurrency market.[41] As such, VDAs are neither here nor there in terms of regulation. Conventional financial markets are regulated to be strict against insider trading, wash trading, spoofing, and other market manipulation. In the Indian crypto world, but in

[41] PwC India, supra note 8, at 24.

reality, there are practically no such protections. In the absence of SEBI regulation, crypto exchanges legally have no obligation to have conventional market surveillance system in place, nor do the issuers of tokens have the obligation to publish standardised, vetted prospectus materials (whitepapers) prior to making the specific assets available to the Indian population.[42]

Although the Advertising Standards Council of India (ASCI) has provided directions in the form of curbing predatory marketing, they are in fact more of reactive steps to promote the asset rather than the structural integrity of the asset itself. Should one of the listed exchanges go bankrupt, or a rogue smart contract operation arise, then the Indian retail investor is statutorily disfavored against a bad cheque, to the equivalent of the Investor Education and Protection Fund (IEPF), or the form of deposit insurance available in conventional banking. The legal connexion is nothing larger than a contract, which can be

[42] Alice M. R., supra note 9, at 312.

influenced by Terms of Service governing one party the service provider massively restricting their liability.[43]

4.1.2 Cross-Border Jurisdictional Friction

Cryptocurrencies are by definition borderless and run on decentralised international registries. This structure goes against the traditional territorial jurisdiction of the law.[44] In the event of a case, like the theft of money in a non-custodial wallet by a foreign unidentified party, or the breakdown of an offshore decentralised finance (DEFi) protocol, Indian law enforcement agencies would be barred at every obstacle possible. It is not yet legally clear how to determine the situs (location) of a digital asset in the event of a civil litigation case, asset recovery or insolvency case under the Insolvency and Bankruptcy Code (IBC), 2016.[45] Offshore exchanges required by the current PMLA are an effort to close this gap with extraterritorial

[43] Yashvi Singh & Rahul Kumar, Virtual Digital Assets under the PMLA: Bridging the Regulatory Gap and the Role of FIU-IND, 26 J. Indian L. Inst. 45, 52 (2024).
[44] Primavera De Filippi & Aaron Wright, supra note 1, at 45.
[45] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India).

registration requirements, though effectively impossible under the current Indian civil procedure to enforce civil liabilities or somehow execute judgments on decentralised autonomous organisations (DAOs).[46]

4.1.3 The Threat of Regulatory Arbitrage

The punitive 30% taxation and 1 percent TDS regime in combination with the heavy compliance burden have been contributing to the culture of regulatory arbitrage inadvertently. Capital and talent are bound to move to a jurisdiction that has more favourable, clear, and comprehensive legal systems. None of these strategies have succeeded in preventing the non-compliant foreign platforms so far, and the tech-savvy Indian investors actively use Virtual Private Networks (VPNs), and non-custodial exchanges (also called DEXs) to circumvent domestic surveillance and taxation.[47] This does not only lead to a huge exchequer loss, but also drives domestic capital towards the

[46] Alice M. R., supra note 9, at 315.
[47] N. R. Mohanty, supra note 7, at 105.

shadow economy, which completely negates the spirit purpose of the monitoring regime of the state.[48]

4.2 The Role of Central Bank Digital Currency (CBDC): The Sovereign Alternative

In response to the spread of the privately held digital resources and in order to protect its monetary sovereignty, the Reserve Bank of India has taken the initiative to introduce its own Central Bank Digital Currency the digital currency of the Rupee (e-Rupee).[49] The legal basis of this was that the Finance Act, 2022, amended Section 2 and the Section 22 of the Reserve Bank of India Act, 1934, brought the definition of the term, bank note, within the provisions of the law of India to include the various forms of electronic money that are issued by the RBI.[50]

4.2.1 Legal Distinction Between CBDC and VDAs

[48] Chainalysis, supra note 33, at 55.
[49] Res. Bank of India, Concept Note on Central Bank Digital Currency 5 (Oct. 2022).
[50] The Reserve Bank of India Act, 1934, § 2, No. 2, Acts of Parliament, 1934 (India).

Law and macroeconomics The e-Rupee, as well as private cryptocurrencies such as Bitcoin, are on opposite sides of the law and macroeconomics even though both apply the same underlying distributed ledger technology (DLT). The e-Rupee is fiat money; it is a direct sovereign debt of the RBI and it qualifies to be legal tender. It is associated with values that are inherent and supported within the macroeconomic apparatus of the Indian state.[51]

On the other hand, VDAs are not considered sovereign value representations, and just as digital representations are treated legally. And they are possessions, or goods, not money. By 2026, the retail and wholesale pilot programmes of CBDC by RBI have been scaled to a considerable extent with providing programmable payments and offline services. The strategic purpose of the state is evident: it seeks to offer the technological efficiencies of blockchain (settlement in real time, no friction, programmability) without the

[51] Rohan Sharma, supra note 10, at 24.

instability and systemic risks of decentralised and privately issued cryptocurrencies.

However, the legal question remains whether the e-Rupee will "crowd out" private cryptocurrencies. Current market dynamics suggest a parallel existence. The e-Rupee is designed for transactional utility and financial inclusion, governed strictly by sovereign monetary policy. Private cryptocurrencies, heavily taxed and monitored, are increasingly viewed by Indian users solely as speculative investment vehicles or alternative asset classes, entirely divorced from the function of money.[52]

4.3 Comparative Perspectives: India vs. The Global Standard (EU MiCA)

In order to have a clue on the shortcomings of India fragmentary approach it is educative to compare it to the holistic global models. Most notable among these is the Markets in Crypto-Assets (MiCA) regulation by the European Union

[52] Id. at 26.

that fully comes into effect in 2024 and 2025, establishing the modern global gold rush in digital asset regulation.[53]

4.3.1 The Taxonomy and Licensing Approach

As opposed to the wide scope, consolidatory definition of VDAs in India under the Income Tax Act, MiCA presents an extraordinarily delicate, legality oriented taxonomically. It classifies crypto-assets into three buckets that include Asset-Referenced Tokens (ARTs), Electronic Money Tokens (EMTs or stablecoins), and other crypto-assets (such as utility tokens).[54]

Imperatively important is that MiCA does not rely on enforcement and regulation but a proactive ex-ante licencing regime. Any other organisation that intends to act as a Crypto-Asset Service Provider (CASP) in the EU has to be first approved by an authoritative body operating in the country.[55] This procedure resembles the close regulations of a

[53] European Parliament and Council Regulation 2023/1114, Markets in Crypto-Assets (MiCA), 2023 O.J. (L 150) 40 (EU).
[54] Id. art. 3.
[55] Alice M. R., supra note 9, at 318.

conventional financial institution. In India, however, a crypto exchange is not subject to any particular operating licence in SEBI or the RBI; it only has to be registered as a reporting entity with FIU-IND to conduct AML, which leaves the expanses of operational risk completely unchecked.

4.3.2 Prudential Requirements and Consumer Protection

MiCA puts the protection of consumers on its core. The token issuers are required to issue a so-called crypto-asset white paper that includes the required and standardised disclosures regarding the project, the underlying technology, the risks, and the rights associated with the tokens. The issuers are legally responsible of misleading or false information in these documents. Moreover, MiCA lays down tough prudential standards on CASPs, and these standards require them to maintain minimum capital bases, separate client

money with proprietary money, and apply effective security measures to cyberspace.[56]

The legal system in place in India does not have these substantive safeguards. Indian approach but it heavily emphasises on the post-factum taxation of gains and tracking down of transactions instead of ex ante control of market behaviour, capital sufficiency and institutional purity. Consequently, the Indian structure is much effective in raising the state revenue, and much weak in protecting the retail investor against structural market failures.[57]

4.4 Global Consensus and the Legacy of India's G20 Presidency

Cryptocurrencies are by their very definition transnational, and so any domestic regulation is always faulty. In understanding this, India used its G20 Presidency in 2023 to shift the global discourse in broken domestic prohibitions to a

[56] European Parliament and Council Regulation 2023/1114, supra note 54, art. 14.
[57] Id. art. 59.

consistent, macro-financial regulation framework.[58]

However, the global policy before 2023 was very fragmented as some countries banned everyone and others became legal providers. The G20 was supported by the synthesis paper that was made in collaboration with the International Monetary Fund (IMF) and the Financial Stability Board (FSB) under the leadership of India. This historic document set an international standard of regulation of cryptos.

Outright, blanket bans were strongly discouraged in the paper on synthesising the IMF-FSB syntheses, as they are hard to implement and usually result in driving such activity into the unregulated shadow economy, an observation on which India had already independently realised following the RBI circular of 2018. Rather, the paper suggested specific regulations to deal with the macroeconomic risks, financial stability, and

[58] Int'l Monetary Fund & Fin. Stability Bd., IMF-FSB Synthesis Paper: Policies for Crypto-Assets 8 (2023).

the certainty of the law.[59] It prioritised the adoption of the Financial Action Task Force (FATF) standards, including the Travel Rule to cryptocurrency transfer.

Other aspects of the Indian G20 Presidency that can continue to be felt by 2026 include the standardisation of AML/CFT standards around the world. The global trend of integrating VDA service providers into the PMLA framework through domestic means in India has been in line with this consensus. Nevertheless, there is still a serious point of departure. Whereas India has been able to lead the call to have the international community regulate the internet through comprehensive regulation across the world, it still has not passed comprehensive and substantive regulation in its own country. The Indian state has also put into effect the restrictive and surveillance-based suggestions of the global consensus but has been reluctant to make facilitative, market-structuring suggestions witnessed in models such as MiCA.

[59] Id. at 12.

Finally, Chapter 4 is characterised by a key dilemma of legal posture in India. India is a facilitator of uniform, coordinated regulation on the international level. Domestically, though, it has to depend on a patchwork of fiscal and criminal statutes which focus more on digital assets as a challenge to contain, as opposed to an innovation to be regulated. The laws on crypto in India will be unprotected by the law until a well-developed statutory framework focuses on getting the interactions between state monitoring and investor protection normal.

5: Conclusion and Suggestions

The legal path of cryptocurrency regulation in India is a captivating research example of how a sovereign state is struggling with the disruptive nature of decentralised technologies. The Indian republic has had an alternate path of scepticism, straightforward prohibition, and its current attitude of restrictive accommodation in the last ten years. This research paper has identified this evolution in systematic order examining the prevailing statutory structure to establish its effectiveness, sustainability and correspondence to international standards. The last chapter summarises the main research conclusions, makes a final decision regarding the present state of affairs in the field of law, and provides tangible political proposals to guide India towards a liberal and inclusive system of digital assets management.

5.1 Summary of Findings

The analysis of the cryptocurrency policy in India shows that this legal framework is extremely disjointed, with a reactive framework. The basic data of this study are the following:

To begin with, the jurisprudential basis of the present Indian market is present to a great extent not through legislation but the influence of the judicial formation. The Supreme Court's 2020 judgment in IAMAI v. RBI dismantled the Reserve Bank of India's disproportionate banking ban, preventing the complete eradication of the domestic industry. But this case did not grant legal rights to digital assets; it just left them in a legislative vacuum which the state has been reluctant to fill with wholesale statutory legislation.

Second, the state has, without a formal Cryptocurrency Act, used Finance Act, 2022, as a basis in order to create a tax and monitor regime. Although the legal definition of Virtual Digital

Assets (VDAs) was long overdue due to the introduction of Section 2(47A) of the Income Tax Act, the punitive 30% capital gains tax, and the limiting 1% Tax Deducted at Source (TDS) of the Sections 115BBH and 194S were both aimed at discouraging retail participation. The study finds that instead of an effective market control, this fiscal asymmetry, especially failure to counterbalance trading losses has stimulated capital flight, initiating an extreme domestic liquidity into offshore platforms with low centralisation and the grey market.

Third, in order to comply with the systemic risks of illicit finance, and in line with the global standards on anti-money laundering (AML), the government included the VDA service providers into the Prevention of Money Laundering Act (PMLA) in 2023. The following enforcement measures against the non-compliant offshore exchange revealed the extraterritoriality of the Financial Intelligence Unit-India (FIU-IND). Nevertheless, though such steps were effective to strengthen the surveillance

perimeter in the state, it is purely administrative. They make no reference to underlying concerns of market integrity, consumer protection or civil liability.

Lastly, there is a contrasting feature at the very end of the comparative analysis that is the distinct polarization of the domestic policy and international stance of India. Although India was able to lead a concerted global macroeconomic framework when it took over as the G20 President, its internal framework is still in drastic need of development as opposed to a global and comprehensive approach to legislative measures such as the Markets in Crypto-Assets (MiCA) regulation in Europe. At the same time, the successful implementation of the RBI Central Bank Digital Currency (e-Rupee), both in the retail and wholesale versions, highlights the obvious lack of preference of the state toward decentralized digital innovation.

5.2 Conclusion

The general finding of this study is that the existing regulatory system towards cryptocurrencies in India, consisting of high taxation and strict enforcement of AML, is an effective temporary solution, but essentially unacceptable as a legal basis in the long term.

The Indian state has effectively ring-fenced its traditional financial economy by considering both the PMLA and the Income Tax Act as the sole remedies to treat VDAs. Nonetheless, enforcement based regulation is an unsatisfactory alternative to substantive law. The existing framework gouges the retail investor and is aware of not safeguarding the commercial investor against market manipulation, insolvency of the platform, or predatory commerce. It leaves the underlying legal issues, including the specific property rights associated with a digital token, the situs of jurisdiction of a decentralized asset, and the civil liability of smart contract developers, completely unsolved.

By 2026, the world has changed its views about doubting the existence of cryptocurrencies to the standardization of its working conditions. Should India keep holding back on the implementation of a audacious, customized statutory framework, then, besides forfeiting its competitive advantage in the ever-expanding Web3 economy, the country will also have lost the capacity to efficiently oversee the billions of dollars of national capital already intermingling with these borderless protocols. It is no longer an option, but a macroeconomic necessity, to have a shift of a more defensive to a proactive, facilitative legal regime.

5.3 Suggestions for Legislative and Policy Reform

In order to address the gaps in the existing model and build a strong and innovation-focused digital asset ecosystem, the paper suggests the following practical legal and policy recommendations:

1. The adoption of a Crypto-Asset Regulation Act.

Parliament of India needs to formulate and pass a stand alone law that expressly regulates the issuance, trading, and holding of digital assets. It is time this Act gives up the homogeneous classification of all tokens as VDAs. Rather, it needs to implement a more subtle taxonomic framework that is legally precise like the MiCA framework used in the EU. The tokens have to be legally distinguished by their economic role; payment tokens (as stablecoins), utility tokens (enabling access to decentralized services), and security tokens (as traditional equity or debt). This classification will enable the targeted regulation and not the blanket, one-size-fits-all regulation.

2. Identification of a Leading Regulatory Authority.

The existing confusion on regulatory jurisdiction should be eliminated. Supervisory roles should be clearly outlined in the proposed Act. The key nodal authorities in controlling crypto-exchanges, market manipulation, and the issuance of security

and utility tokens should be empowered to the Securities and Exchange Board of India (SEBI). Reserve Bank of India (RBI) on the other hand should have the sole mandate on stablecoins (Asset-Referenced Tokens) since this has direct monetary policy and fiat liquidity implications, comparable to how it is holding the CBDC.

3. The Fiscal Regime Rationalization.

In order to end the high regulatory arbitrage and to reintegrate the offshore capital into the home, compliant ecosystem, the Ministry of Finance needs to rationalize the VDA taxation system. Punitive 1% TDS in Section 194S needs to be dropped to 0.1 percent or 0.01 percent the rate that would ensure a transactional trail at FIU-IND without obliterating market-making liquidity. Moreover, the set-off between losses incurred on a single VDA and gains incurred on another VDA should be amended by Section 115BBH to bring the taxation of digital assets in line with the fair

application of the principles of equitable treatment of the traditional equities and commodities.

4. Mechanisms of Consumer Protection Institutionalization.

The ex-ante requirements in the new statutory framework should focus on protecting retail investors. The CASPS in India should be legally required to:

- Publicly Release Vetted Whitepapers: Require the publication of standard, legally binding prospectus documents prior to any new token ever being sold to the Indian populace, and including the risks of the project, tokenomics, and the identity of the people behind the project.
- Mandatory Proof of Reserves (PoR): Enforce exchanges to provide and publish independent, periodically-undertaken cryptographic audits that client obligations are fully hedged 1:1 by on-chain assets, such that

localized collapse along the lines of the global FTX contagion cannot occur.

- Segregation of Funds: Impose severe statutory rules in which no exchange may mix proprietary corporate funds with retail client deposits or use client assets to engage in producing unapproved proprietary yield.

5. Creation of Investor Education and Protection Fund (IEPF).

Lastly, a small portion of the large amount of tax revenue generated by the 30% VDA capital gains tax should be put into law to create a separate Digital Asset Investor Education and Protection Fund. This fund would serve to proactively educate the Indian demographic regarding the technical risks of self-custody and decentralized finance (DeFi), while also providing a limited financial backstop or legal aid for victims of complex smart contract exploits or organized crypto fraud.

By implementing these suggestions, India can successfully bridge the gap between sovereign

security and technological progress, establishing a legal framework that not only safeguards its macroeconomic stability but also positions the nation as a secure, regulated hub for the future of digital finance.