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Cryptocurrency Regulation in India: Challenges, Opportunities, and the Way Forward

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Abstract. *India occupies a paradoxical position in the global cryptocurrency landscape: it has topped Chainalysis's Global Crypto Adoption Index for three consecutive years, yet it still has no dedicated legislation governing virtual digital assets (VDAs) [1][8]. Regulation has instead evolved through a patchwork of taxation law, anti-money-laundering rules, central bank circulars, and judicial intervention. This paper traces the evolution of India's regulatory approach from the Reserve Bank of India's (RBI) 2018 banking restriction through the Supreme Court's 2020 reversal, the 2022 taxation regime, the 2023 anti-money-laundering notification, and the still-unsettled position as of mid-2026. It examines the principal challenges regulatory fragmentation, punitive taxation, financial-stability concerns, and enforcement gaps with offshore exchanges alongside the opportunities presented by India's demographic and technological advantages, its leadership role in shaping the G20's global crypto framework, and the parallel development of the central bank digital currency (CBDC). The paper concludes with policy recommendations for a coherent, risk-calibrated regulatory framework.*

Keywords: Cyptocurrency, Digital Financial Literacy, India, Digital, Virtual.

Introduction

Virtual digital assets have moved from a fringe technological curiosity to a mainstream financial phenomenon in India over the past decade. Despite the absence of comprehensive legislation, India has consistently ranked among the world's largest crypto markets by user base and transaction value, and Chainalysis placed it first overall in its 2025 Global Crypto Adoption Index, topping all four sub-indices the index measures [1]. This adoption has occurred not because of a permissive regulatory environment but largely in spite of a restrictive one: India imposes a flat 30 percent tax on crypto gains with no provision for offsetting losses, alongside a 1 percent tax deducted at source (TDS) on transactions above a threshold [2][7].

The regulatory story of cryptocurrency in India is therefore less a story of a single law than of an evolving, multi-agency response shaped by court rulings, tax notifications, and anti-money-laundering compliance requirements. This paper analyses that evolution, identifies the structural challenges it has produced, surveys the opportunities that a more coherent framework could unlock, and proposes a way forward.

Evolution of India's Regulatory Approach

2.1 The RBI Ban and Judicial Reversal (2018–2020)

On 6 April 2018, the RBI issued a circular directing regulated banking entities to stop providing services to individuals and businesses dealing in virtual currencies, citing concerns about money laundering, terrorist financing, and consumer protection [3]. The circular effectively cut off banking access for exchanges and traders. The Internet and Mobile Association of India (IAMAI) challenged the circular before the Supreme Court in Writ Petition (Civil) No. 528 of 2018.

On 4 March 2020, a three-judge bench of the Supreme Court — comprising Justices Rohinton Fali Nariman, Aniruddha Bose, and V. Ramasubramanian — set aside the RBI circular on the ground of proportionality [4][5]. The Court held that while the RBI possessed statutory authority under the Banking Regulation Act, 1949, the RBI Act, 1934, and the Payment and Settlement Systems Act, 2007 to regulate risks connected to virtual currencies, the blanket restriction on banking access was disproportionate because the RBI had not demonstrated actual, empirical harm to regulated entities from crypto-related banking transactions [4]. The judgment restored banking access to the sector but stopped short of creating any comprehensive framework, leaving the underlying legal status of cryptocurrency undefined [3][4].

2.2 The Taxation Regime (2022)

In the absence of a dedicated crypto law, taxation became the government's primary regulatory lever. The Finance Act, 2022 inserted Section 115BBH into the Income-tax Act, imposing a flat 30 percent tax on income from the transfer of VDAs, without allowing deductions other than the cost of acquisition, and without permitting losses on one VDA to be set off against gains on another or against other income [2][7]. Section 194S simultaneously introduced a 1 percent TDS obligation on VDA transfers above a specified threshold, intended to create an audit trail of transactions [2][7]. From April 2026, stricter reporting standards took effect, with daily penalties for inaccurate transaction reporting by reporting entities [5].

2.3 Anti-Money-Laundering Coverage (2023)

A significant step toward formal oversight came on 7 March 2023, when the Ministry of Finance notified that entities providing services related to VDAs — including exchanges, custodial wallet providers, and related intermediaries — would be treated as "reporting entities" under the Prevention of Money Laundering Act, 2002 (PMLA) [6]. This brought Indian and India-facing crypto businesses within the compliance architecture administered by the Financial Intelligence Unit–India (FIU-IND), requiring registration, know-your-customer (KYC) checks, and suspicious-transaction reporting [6]. Enforcement initially targeted domestic centralised exchanges before turning to offshore platforms; in December 2023, FIU-IND issued show-cause notices to several major global exchanges, including Binance and Kraken, for operating without registration [6].

2.4 The Unsettled Present (2024–2026)

Despite these incremental measures, India still lacks a comprehensive crypto law as of mid-2026 [7][8]. In 2024, the Supreme Court reportedly urged the government to enact legislation to prevent misuse of the sector, and in early 2026 the Orissa High Court asked the central government to clarify the legal status of cryptocurrency in a case concerning frozen bank accounts linked to crypto transactions [9]. A draft Crypto Currency Regulation Bill remains under discussion, and reports in 2026 indicate the RBI continues to favour a cautious or restrictive stance while the Income Tax Department has flagged the difficulty of monitoring trades routed through overseas exchanges [1][10]. The Securities and Exchange Board of India (SEBI) has been examining a framework that could bring securities-like tokens under securities law, and a discussion paper covering decentralised finance (DeFi) and staking was expected later in 2026, though no formal notification had been issued as of mid-2026 [8][11]. India is also set to join the OECD's Crypto-Asset Reporting Framework (CARF) for cross-border data sharing, beginning in April 2027 [7].

Key Challenges

3.1 Regulatory Fragmentation and Legal Uncertainty

India does not have a single regulator for virtual digital assets. Responsibility is currently distributed across the RBI (monetary and financial stability), SEBI (potential securities-type tokens), the Ministry of Finance and FIU-IND (anti-money-laundering compliance), and the Income Tax Department (taxation) [1][8]. This fragmentation means crypto assets are simultaneously taxed as property, monitored as a money-laundering risk, and treated as a subject of macro-financial concern, without a unifying statute that defines their legal character. Courts have had to step in more than once — the Supreme Court in 2020 and the Orissa High Court in 2026 — to press the government for clarity, underscoring the practical costs of prolonged ambiguity for investors, startups, and law enforcement alike [4][9].

3.2 Punitive and Distortive Taxation

The 30 percent flat tax with no loss offset, combined with the 1 percent TDS, has been widely characterised by industry participants as disproportionate relative to global norms and as a driver of trading migration to offshore and peer-to-peer platforms that fall outside India's compliance net [2][5][7]. Ironically, the same tax regime that aims to discourage speculative trading and improve traceability has arguably encouraged some traders to route activity through platforms the government finds hardest to monitor.

3.3 Enforcement Gaps with Offshore Exchanges

Even after the 2023 PMLA notification, enforcing compliance against offshore exchanges serving Indian customers has proved difficult. FIU-IND's show-cause notices to major global platforms in December 2023 illustrated both the government's intent to assert jurisdiction and the practical limits of enforcement against entities with no physical presence in India [6]. The Income Tax Department has separately noted the difficulty of tracking transactions conducted through overseas exchanges [1][10].

3.4 Financial Stability and Monetary Policy Concerns

The RBI has repeatedly expressed concern that widespread private crypto adoption could undermine monetary policy transmission, encourage capital flight, and expose retail investors to volatility, fraud, and scams [1]. These concerns have periodically translated into a policy preference within the central bank for restrictive or even prohibitive measures, creating tension with the Ministry of Finance's more innovation-oriented posture and with India's own G20-era advocacy for coordinated, non-prohibitive global standards [1][10][14].

3.5 Absence of Investor Protection Infrastructure

Because VDAs are not recognised as legal tender or as a regulated security or commodity in most cases, retail investors currently lack sector-specific protections such as mandatory disclosure standards, custody safeguards, or a formal grievance-redress mechanism comparable to those in regulated securities markets [7][8]. This gap sits uneasily alongside India's position as the world's leading market by grassroots crypto adoption [1].

Opportunities

4.1 Demographic and Digital Infrastructure Advantages

India's crypto adoption has been driven by structural strengths rather than by regulatory encouragement: low-cost mobile data, internet penetration approaching 900 million users, a young and digitally literate population, and high remittance demand supporting stablecoin usage [1]. The maturity of India's digital public payments infrastructure, particularly the Unified Payments Interface (UPI), has helped normalise digital financial behaviour more broadly, indirectly easing the path to crypto adoption even without direct interoperability between UPI and crypto platforms [1]. Industry observers have argued that a clearer regulatory framework would convert this grassroots strength into more durable institutional participation, reducing the uncertainty that currently deters larger investors [1].

4.2 Leadership in Shaping Global Standards

India used its 2023 G20 presidency to push for a globally coordinated approach to crypto-asset regulation rather than a patchwork of unilateral national responses. At India's request, the International Monetary Fund (IMF) and the Financial Stability Board (FSB) jointly produced a Synthesis Paper, released in September 2023, consolidating existing international standards on macroeconomic and financial-stability risks associated with crypto-assets, including stablecoins and DeFi [12][13]. The G20 subsequently endorsed a roadmap for implementing these recommendations, with the FSB tasked with reviewing implementation progress and the IMF assessing macroeconomic implications, particularly for emerging market and developing economies [13][15]. This diplomatic initiative positions India to influence, rather than simply follow, the international regulatory consensus that will eventually shape its own domestic framework.

4.3 Parallel Development of a Central Bank Digital Currency

The RBI has pursued the Digital Rupee (e₹) as a sovereign, legal-tender alternative to private cryptocurrency, running separate wholesale and retail pilots since November and December 2022 respectively [16][17]. While retail e₹ circulation and transaction volumes remain a small fraction of UPI's scale, the RBI has continued to expand pilot use cases, including offline transactions, programmable welfare disbursements routed through state government pilot programmes, and a proposal to explore linking CBDCs across BRICS economies [18][19][20]. A mature CBDC infrastructure could give India a state-backed digital settlement rail that coexists with, and provides a policy-safe benchmark against, private VDAs — potentially informing how the RBI eventually calibrates its stance toward the private crypto sector [18].

4.4 Innovation, Employment, and Fintech Ecosystem Growth

India's blockchain and Web3 startup ecosystem, along with industry bodies such as the Bharat Web3 Association, has continued to grow despite regulatory uncertainty, and has actively worked to demonstrate legitimate use cases for digital assets, including cross-border remittances [1]. A predictable licensing and compliance regime — of the kind envisioned in draft crypto bill proposals involving asset classification and sandbox programmes for DeFi and NFTs — could reduce the incentive for talent and capital to relocate to more accommodating jurisdictions, a risk that industry commentators have repeatedly flagged [1][7].

The Way Forward: Policy Recommendations

Drawing on the trajectory outlined above, several directions for reform emerge:

1. Enact a dedicated Virtual Digital Asset law. A single statute that defines VDA categories (utility, security, and payment tokens, as contemplated in draft proposals), designates clear regulatory jurisdiction, and codifies investor-protection standards would resolve the fragmentation that currently spans the RBI, SEBI, the Finance Ministry, and the tax authorities [1][8].
2. Recalibrate the tax regime. Allowing loss offsets and reconsidering the TDS rate and threshold could reduce the incentive for traders to migrate to offshore or peer-to-peer channels, without necessarily lowering the overall tax take, since better compliance on a broader onshore base may offset a lower marginal rate [2][5][7].
3. Strengthen cross-border enforcement cooperation. Full implementation of the OECD's CARF from 2027, combined with continued FIU-IND engagement with offshore exchanges, should be prioritised to close the offshore monitoring gap identified by tax authorities [6][7].
4. Align domestic rules with the G20/IMF-FSB roadmap. Since India was instrumental in commissioning the IMF-FSB Synthesis Paper, adopting its recommendations domestically — particularly on stablecoin oversight and DeFi risk monitoring — would let India model the coordinated approach it advocated internationally [12][13].
5. Clarify the RBI-SEBI division of labour. A functional split, with SEBI overseeing securities-like and investment-type tokens and the RBI retaining oversight of payment-type tokens and stablecoin-adjacent risks, would mirror approaches under consideration elsewhere and reduce turf-related delay [8][11].
6. Continue calibrated CBDC development without conflating it with private VDA policy. The Digital Rupee and private cryptocurrencies serve different functions, and pilots should continue to mature independently of the timeline for private-sector regulation, so that CBDC rollout is not used as a substitute for addressing the private market [1][18].

Conclusion

India's cryptocurrency sector presents a genuine paradox: extraordinary grassroots adoption sitting atop a fragmented, tax-driven, and still-incomplete regulatory architecture. The Supreme Court's 2020 intervention removed an outright barrier to banking access but did not supply the comprehensive framework that courts have since repeatedly asked the government to provide. Taxation and anti-money-laundering rules have filled part of the vacuum, but they address compliance and revenue objectives rather than investor protection or market structure. At the same time, India's demographic advantages, its diplomatic leadership in shaping the G20's global crypto policy roadmap, and the parallel maturation of the Digital Rupee give it unusual resources with which to build a considered, internationally aligned framework — provided policymakers move from an ad hoc, agency-by-agency response to a coherent statute that finally answers the question courts have twice had to ask the government to resolve.

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