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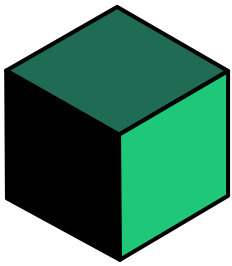
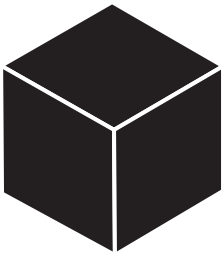


Block by Block

A Compendium of Research Papers on
Regulatory Pathways for Virtual Digital Assets

TRILEGAL

Centre for Technology, Entertainment and Sports Law, NUJS-Kolkata



Block by Block

A Compendium of Research Papers on
Regulatory Pathways for Virtual Digital Assets

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FOREWORD

CoinSwitch, India's largest crypto trading platform, in partnership with India's leading law firm Trilegal, and the Centre for Technology, Entertainment and Sports Law at the WB National University of Juridical Sciences, Kolkata ('NUJS Kolkata'), launched 'Block by Block', a national-level paper presentation competition focused on Virtual Digital Assets ('VDAs'), in July 2025.

The competition aimed to engage and challenge law and public policy students at Indian universities to develop innovative, practical policy proposals on the regulation of VDAs in India. Participants were invited to submit papers on the theme: 'A Policy Approach for Regulation of Virtual Digital Assets/Crypto assets to Foster the Growth of a New Asset Class in India'.

This book, which presents the five best papers shortlisted by the jury from entries from across the country, is a testament to the quality of research and efforts on display by students in the competition. The submissions were evaluated based on multiple parameters including originality, research and evidence, analytical rigor, clarity and structure. These papers discuss in detail different approaches to regulating VDAs in India. We received an overwhelming response to the competition. We congratulate all participants in their sincere efforts and enthusiastic participation.

We hope that the ideas articulated in the papers pique the interests of all stakeholders – students, academicians, researchers, policymakers, legal professionals and others.

We want to place on record our sincere appreciation to fellow jury members and colleagues at CoinSwitch, Trilegal and NUJS Kolkata for their contributions towards the publication of this volume.

Ashish Singhal
Co-founder, CoinSwitch

Jaideep Reddy
Partner, Trilegal

Dr. Shameek Sen
Professor, NUJS Kolkata

DISCLAIMER

The papers published as part of this book were shortlisted entries as part of a paper presentation competition, 'Block by Block – A Paper Presentation Competition on Virtual Digital Assets', organised by CoinSwitch in partnership with Trilegal and the Centre for Technology, Entertainment, and Sports Law at the WB National University of Juridical Sciences, Kolkata (NUJS CTESL) (together, the 'Organisers') in July 2025. Each paper represents the independent research, views, and opinions of its respective author(s). These views do not reflect the views, positions, or opinions of the Organisers, the editors, or the publishers.

The inclusion or publication of any paper in this book does not amount to an endorsement, approval, or certification by the Organisers of the views, analyses, findings, or conclusions expressed by the authors.

All papers in this volume are intended solely for academic, educational, and research purposes. Nothing in this book should be construed as legal advice, financial advice, investment advice, or as a recommendation with respect to virtual digital assets, crypto-assets, or any related products or services.

The Organisers make no representations or warranties, express or implied, regarding the accuracy, completeness, or suitability of any information contained in the papers, and expressly disclaim any liability arising from reliance on the material herein.

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A POLICY FRAMEWORK FOR REGULATION OF VIRTUAL DIGITAL ASSETS IN INDIA

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The policy document has been conceptualized and drafted primarily through original analysis and independent research. Limited assistance was sought from artificial intelligence platforms, specifically ChatGPT, Perplexity, and Anara, for the purpose of generating an initial outline and providing minimal drafting support. Such use was restricted to organizational guidance, language refinement, and structural clarity, without reliance on AI for substantive arguments or core content. The final articulation, legal reasoning, and policy recommendations presented herein are entirely the result of the author's original thought process and academic engagement with the subject of virtual digital assets. All interpretations, conclusions, and proposals expressed remain the author's sole intellectual contribution.

ABSTRACT

India's treatment of virtual digital assets has so far focussed more on taxation and anti-money laundering than on coherent regulation. Oversight is scattered across agencies, leaving businesses and investors with unclear rules and inconsistent compliance demands. Due to this uncertainty, domestic growth has slowed, and many startups have been enticed to relocate their operations or capital overseas. India runs the risk of losing out on the opportunities that digital assets are generating in international markets if its policy foundation is weaker.

A practical approach would be to classify virtual digital assets into distinct categories, set up a single coordinating authority, adjust taxes to ensure they are fair but not stifling, and allow controlled testing of new products through innovation sandboxes. These measures would enable us to build investor trust, improve anti-money laundering safeguards, and reduce the flight of capital and talent. Most importantly, they would give India a stable base to develop its own digital asset ecosystem rather than watching growth shift elsewhere.

I. INTRODUCTION

India recently created a statutory and regulatory environment for virtual digital assets ('VDAs') based on the increasing importance of digital finance and the requirements of investor protection, financial integrity, and international coordination. The Finance Act, 2022 ('Finance Act'), was an important milestone, bringing taxation and reporting requirements for VDAs. Under Section 2(47A) of the Income Tax Act, 1961 ('Income Tax Act'), VDAs are broadly defined as any form of digital value representation, created by way of cryptography or otherwise, which is used as a store of value, a unit of account, or can be applied for making transactions or investments, excluding legal tender specifically.[1] The income from VDA transfers is subject to a uniform 30%

1 Income-tax Act, 1961, § 2(47A) (India).

tax under Section 115BBH, with the acquisition cost being the only amount that can be deducted and no allowance for loss set-off.[2] In order to improve reporting compliance and give the government the ability to keep an eye on these transfers, Section 194S additionally mandates a 1% Tax Deducted at Source ('TDS') on VDA transactions.[3]

The Central Board of Direct Taxes ('CBDT') has provided guidelines explaining compliance requirements. At the same time, some instruments, like loyalty points, reward cards, gift vouchers, and non-fungible tokens ('NFTs') associated with physical assets, are exempted from the VDA definition. The Financial Intelligence Unit - India ('FIU-IND') oversees VDA service providers for adherence to anti-money laundering ('AML') and combating the financing of terrorism ('CFT') requirements.[4] All the domestic and offshore VDA service providers operating in India as of July 4, 2024, should have registered with FIU-IND to ensure compliance with the Prevention of Money Laundering Act, 2002 ('PMLA') and related AML/CFT regulations. Registration involves filing financial statements, tax returns, incorporation papers, and the appointment of a 'principal officer' and a 'designated director' to implement the PMLA rules.[5]

The enforcement mechanism of Section 48 of the PMLA authorises authorities such as the Director, Additional or Joint Director, Deputy Director, and Assistant Director to oversee compliance.[6] Non-registration with FIU-IND warrants certain consequences such as warnings, directions for compliance action, monetary penalties, or, in association with the Ministry of Electronics and Information Technology ('MeitY'), blocking of mobile applications and URLs. FIU-IND also receives Cash Transaction Reports (CTRs) and Suspicious Transaction Reports ('STRs') centrally and analyses patterns of money laundering, and shares intelligence with domestic and foreign authorities.[7]

The Reserve Bank of India ('RBI') concerns itself with monetary stability, credit flow, inflation management, issuance of currency, and oversight of cross-border financial transactions. The RBI focuses on monetary stability, regulation of banks, issue of currency, control of inflation, and regulation of credit flow. Up to 2024-2025, the RBI has kept the repo rate constant at 6.5%, with the Cash Reserve Ratio

2 Income-tax Act, 1961, § 115BBH (India).

3 Income-tax Act, 1961, § 194S (India).

4 KPMG in India, CBDT issues notifications on the definition of virtual digital asset, prescribes list of excluded assets and defines non-fungible tokens, KPMG (July 5, 2022), https://www.in.kpmg.com/taxflashnews/KPMG-Flash-News-CBDT-Notification-on-the-definitionition-of-VDA.pdf.

5 Shivam Mishra & Pranav Dabas, FIU-IND: Safeguarding Financial Integrity Through PMLA Compliance And Global Cooperation, Mondaq (July 10, 2024), *available at* https://www.mondaq.com/india/money-laundering/1490910/fiu-ind-safeguarding-financial-integrity-through-pmla-compliance-and-global-cooperation.

6 Prevention of Money Laundering Act, 2002, § 48 (India).

7 Anu Tiwari, Pallavi Rao, Utkarsh Bhatnagar & Shrish Gautam, *FIG Paper (No. 33 – Series 2): Compulsory Registration of Off-shore Virtual Digital Asset Service Providers with FIU-IND?,* Cyril Amarchand Mangaldas (Jan. 25, 2024), https://corporate.cyrilamarchandblogs.com/2024/01/fig-paper-no-33-series-2-compulsory-registration-of-off-shore-virtual-digital-asset-service-providers-with-fiu-ind/.

(CRR) at 4.0% (down from the previous 4.5%), and the Statutory Liquidity Ratio (LR) unchanged at 18% for Indian banks.[8]

The RBI also holds large foreign exchange reserves and explained that its earlier 2018 circular prohibiting cryptocurrencies was made useless by the Supreme Court's 2020 judgment.[9] The National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) are governed by the Securities and Exchange Board of India ('SEBI'), which also investigates insider trading and manages the SCORES platform to handle investor complaints. Though VDAs are not yet recognised as securities under the Securities Contracts (Regulation) Act, 1956, SEBI would be the key regulator in the event of such recognition. VDA taxation, including the flat 30% tax, expense disallowance, and TDS requirement, is handled by the CBDT, with inter-regulatory coordination being eased through organisations like the Inter-Regulatory Technical Group on FinTech.

The Supreme Court overturned the prohibition by RBI on banks handling cryptocurrencies in Internet and Mobile Association v. RBI ('IAMAI v. RBI'),[10] ruling that it infringed upon the fundamental right to trade as guaranteed by Article 19(1)(g)[11] and made room for statutory regulation of VDAs. In Shailesh Babulal Bhatt v. State of Gujarat & Others,[12] the Court underlined the necessity of a unified cryptocurrency regime, referring to the obsolescence of current laws in the context of the decentralised and trans-border nature of digital assets and to concerns pertaining to enforcement, fraud, and money laundering.

The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 prohibits private cryptocurrencies but permits central bank digital currency ('CBDC').[13] However, this has not been in effect yet. Thus, this indicates that the coordination of regulation of the rapidly evolving digital asset landscape is needed globally, and India's G20 Presidency has spearheaded discussions with the Financial Stability Board ('FSB') and the International Monetary Fund ('IMF') to develop a "G20 Roadmap on Crypto Assets." [14]

8 Reserve Bank of India, Governor's Statement: February 8, 2024, Press Release, Reserve Bank of India (Feb. 8, 2024), *available at* https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=57277.

9 BW Online Bureau, India's Forex Reserves Climb To $676 Bn In Fifth Consecutive Weekly Gain, BusinessWorld (Apr. 19, 2025), https://www.businessworld.in/article/indias-forex-reserves-climb-to-676-bn-in-fifth-consecutive-weekly-gain-554204.

10 Internet & Mobile Association of India v. Reserve Bank of India, (2020) SCC Online SC 275 (India).

11 India Const. art. 19, cl. 1(g).

12 Shailesh Babulal Bhatt v. State of Gujarat & Others, SLP (Crl.) No. 4036/2025 (Sup. Ct. India 2025).

13 Cryptocurrency and Regulation of Official Digital Currency Bill, No. 142 of 2021, Lok Sabha (India).

14 G20, Presidency Note on Framework for Crypto Assets (2023), https://www.g20.in/content/dam/gtwenty/gtwenty_new/document/Presidency_note_on_Framework_for_Crypto_Assets.pdf.

II. GLOBAL REGULATORY LANDSCAPE FOR CRYPTO-ASSETS

There are many different approaches in the global regulatory environment for crypto-assets, ranging from comprehensive, custom frameworks to fragmented or enforcement-driven models. Despite some common trends, the international regulatory environment for crypto-assets exhibits a wide range of approaches, from comprehensive, custom frameworks to fragmented or enforcement-driven models. While there are some commonalities, like an emphasis on investor protection and stablecoins, jurisdictions differ significantly in terms of design and enforcement, which can assist India in its policy-making process.

A. EUROPEAN UNION

The European Union ('EU') adopted a whole-of-regulatory framework for digital assets with the Markets in Crypto-Assets Regulation ('MiCA'), which came into force in June 2023. MiCA unites previously disparate national regimes, imposing the same rules on issuers of digital assets and Crypto Asset Service Providers ('CASPs'). It creates legal certainty for non-EU-defined digital assets, provides a level playing field throughout the EU, and lays down precise rules for stablecoins, such as e-money tokens ('EMT') and asset-referenced tokens ('ART'), but not algorithmic stablecoins.[15]

The application of MiCA was staggered as EMT and ART provisions became effective in June 2024, while the other obligations were implemented in December 2024. The regulation does not apply to CBDCs, tokenised securities (under the Markets in Financial Instruments Directive II), NFTs, and decentralised finance ('DeFi') activities. It aims at promoting innovation, safeguarding investors, and avoiding talent and capital flight. European Securities and Markets Authority (ESMA) guidance and other EU authority technical standards and consultations have brought MiCA into operation. Taxation is still a member state affair, with the majority of EU states taxing gains on crypto as capital gains, and a sign of ongoing lack of tax harmonisation.[16]

15 Stoyan Djourov, MiCA: The EU's Path to Digital Assets Regulation, Fidelity Digital Assets (Sept. 14, 2023); World Economic Forum, *Pathways to Crypto-Asset Regulation: A Global Approach* (White Paper, May 2023), *available at* https://www.weforum.org/publications/pathways-to-crypto-asset-regulation-a-global-approach.

16 *ibid.*

B. UNITED STATES

In the United States, regulation of digital assets is typically based on enforcement. The Howey test establishes whether a digital asset would be considered a security, with the Securities and Exchange Commission ('SEC') acting as the principal regulator. Well-known enforcement actions like SEC v. Coinbase[17] and SEC v. Ripple[18] have caused legal ambiguity. There is disagreement regarding the status of other tokens, like Ether, but most people agree that Bitcoin is not a security.[19]

The lack of a federal crypto law has resulted in state-level fragmentation and regulatory divergence. Federal legislation, including the Lummis–Gillibrand Responsible Financial Innovation Act, has yet to pass, so litigation has become the main instrument of regulation. Taxation falls within the remit of the Internal Revenue Service (IRS), which considers digital assets property, and disposals are typically subject to capital gains tax.[20] Regulatory uncertainty and inconsistent state regulations have led some participants to move offshore.

C. UNITED KINGDOM

The United Kingdom ('UK') has implemented a piecemeal asset-specific approach to regulation under the Financial Services and Markets Act, 2023 in amending Financial Services and Markets Act, 2000 to define "digital settlement assets," which include primarily stablecoins, and to recognise them as a genuine form of payment. The Financial Conduct Authority ('FCA') takes action against promotions for digital assets and for any activities related to them, based on the "same risk, same regulatory outcome", and it protects consumers through consultations and enforcement. The tax works on existing rules: selling off crypto is typically subject to capital gains tax, and business trading to income tax.[21]

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17 *Securities and Exchange Commission v. Coinbase, Inc.,* No. 1:23-cv-04738-KPF, 2024 WL [pending F. Supp. 3d] (S.D.N.Y. Mar. 27, 2024) (Katherine Polk Failla, J.).

18 *Securities and Exchange Commission v. Ripple Labs, Inc*., 682 F. Supp. 3d 308 (S.D.N.Y. 2023), motion to certify appeal denied, 697 F. Supp. 3d 126 (S.D.N.Y. 2023).

19 Eva Su, *Digital Assets and SEC Regulation*, CRS Report No. R46208 (June 23, 2021), available at Congress.gov.

20 Eden L. Rohrer & Judith E. Rinearson, 10 Impactful Provisions of the Lummis-Gillibrand Bill, National Law Review (June 7, 2022), *available at* https://www.natlawreview.com/article/10-impactful-provisions-lummis-gillibrand-bill.

21 Ian Greenwood, *Changes to UK GAAP: amendments to lease accounting*, KPMG in the UK (Mar. 27, 2024), *available at* https://kpmg.com/uk/en/insights/finance/changes-to-uk-gaap-amendments-to-lease-accounting.html; PwC, *PwC Global Crypto Regulation Report 2023* (Dec. 19, 2022, amended to include BCBS rules), https://www.pwc.com/gx/en/about/new-ventures/crypto-center.html.

D. SINGAPORE

Singapore mainly governs digital tokens under the Payment Services Act, 2020 ('PSA'), combining regulation of traditional and digital payment services under one framework. The PSA mandates licensing for exchanges, custodians and other service providers, in addition to stringent AML/CFT requirements. In August 2023, Monetary Authority of Singapore ('MAS') established a particular framework for stablecoins, which are categorised as "MAS-regulated stablecoins" which comply with specific criteria in relation to capital adequacy, redemption rights and disclosure. Singapore offers one of the most crypto-friendly taxation environments in the world - cryptocurrencies are treated as a digital product, and capital gain is untaxed (individual investors, if not trading crypto as part of businesses, will not be taxable for personal asset income). MAS' model strikes the right balance between innovation and strict regulatory oversight, enhancing Singapore's proposition as a fintech hub.[22]

These models reflect the range of regulatory responses from a complete ban at one end of the policy spectrum to layered licensing systems at the other and show the different policy concerns and institutional features they entail.

III. POLICY OBJECTIVES FOR INDIA

The cryptocurrency regulatory framework in India must carefully balance the promotion of technological innovation, protection of investors, its maintenance as a credible financial integrity system, and its nurturing as a global marketplace. Worldwide, tax consistency continues to pose a challenge that India cannot afford to ignore because an inconsistency in taxation would have the effect in practice of pushing business offshore.

One of the main policy objectives should be to support blockchain and Web3 innovation by establishing open, supportive regulatory frameworks, operational sandboxes, and safe-harbour clauses. In addition to encouraging the growth of domestic startups and attracting foreign investment, such measures would lower the risk of talent migration. One example of how blockchain technology can improve financial inclusion is DeFi, which leverages India's robust fintech and IT infrastructure to establish the country as a global leader in digital financial services. Investor protection must be reinforced at the same time by mandatory disclosures, strict marketing laws, suitability standards, and comprehensive financial literacy programs to lessen

22 Kenneth Pereire & Lin YingXin, Blockchain & Cryptocurrency Laws and Regulations 2025 – Singapore, Global Legal Insights (Oct. 25, 2024), https://www.globallegalinsights.com/practice-areas/blockchain-cryptocurrency-laws-and-regulations/singapore; Monetary Authority of Singapore, Guidelines on Consumer Protection Measures by Digital Payment Token Service Providers, Guideline No. PS–G03 (Issued on Apr. 2, 2024, effective Oct. 4, 2024) (Singapore).

exposure to domestic frauds like GainBitcoin and well-known global failures like FTX.[23]

AML and CFT laws must be strictly followed.[24] It includes enforcing the know-your-customer (KYC) protocols, mandating virtual asset service providers ('VASPs') to report any suspicious activity, and observing transactions. India must strategically utilise blockchain technology to allow affordable cross-border transfers, being the largest global recipient of remittances. The rationalisation of TDS provisions, the clarification of Goods and Services Tax ('GST') applicability, and the alignment of cryptocurrency taxation with current financial instruments can retain the fiscal safeguards without impeding domestic participation.[25]

Finally, drawing in institutional investment and incorporating India into international capital flows depend on appropriate and consistent regulation. In accordance with international standards set by the IMF, Financial Action Task Force ('FATF'), MiCA, and the G20 roadmap, policy coherence and coordinated oversight across the RBI, SEBI, the Ministry of Finance, and enforcement agencies will improve regulatory credibility, guarantee stability, and lay the groundwork for an innovative, safe, and competitive cryptocurrency ecosystem in India.[26]

IV. POLICY FRAMEWORK

A. CLASSIFICATION AND LEGAL TAXONOMY

Truthfully, one cannot regulate what one cannot even describe. The Income Tax Act, after its 2022 amendments, did create a category called "virtual digital assets." However, the label is so broad that it covers a Bitcoin mined a decade ago, an NFT tied to a cricket highlight, and a fiat-backed stablecoin designed to mimic the rupee. By placing them all under one umbrella, the law forces regulators to apply the same rulebook to things that are not cousins.

The EU has already shown why classification matters. The MiCA adopted in 2023, sets out three separate categories: asset-referenced tokens, e-money tokens, and other crypto-assets, each treated differently in terms of disclosure and supervision.[27] Switzerland's Financial Markets Supervisory Authority (FINMA) did

23 Xiangjuan, J., Xinwei, F., Yijie, Z. *et al.* Integration and innovation of blockchain in Web3.0: current status and standardization prospects. *World Wide Web* 28, 7 (2025). https://doi.org/10.1007/s11280-024-01319-7.

24 International Monetary Fund, Anti-Money Laundering and Combating the Financing of Terrorism, International Monetary Fund (n.d.), *available at* https://www.imf.org/en/Topics/Financial-Integrity/amlcft.

25 Securities and Exchange Board of India, Master Circular on Guidelines on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT)/Obligations of Securities Market Intermediaries under the Prevention of Money Laundering Act, 2002, SEBI/HO/MIRSD/MIRSDSECFATF/P/CIR/2024/78 (Issued on June 6, 2024) (India).

26 *ibid.*

27 *Markets in Crypto-Assets Regulation* (EU) 2023/1114, OJ L 150/40, 9 June 2023.

something similar in 2018 when it divided tokens into payment, utility, and asset tokens.[28] And the UK FCA's 2019 guidance created categories of exchange, utility, and security tokens.[29] These examples show that taxonomy is not a matter of bureaucratic neatness; it is the only way to ensure proportionality.

For India, a simple yet workable classification might involve five baskets: payment tokens (like Bitcoin or stablecoins), utility tokens (used for access to services), security tokens (which mimic shares or debt), NFTs, and a special category that interacts with the RBI's CBDC. Without such distinctions, every other debate, on taxation, disclosure, or licensing, will rest on shaky ground.

B. REGULATORY TURF AND THE CASE FOR COORDINATION

India's regulatory map is fragmented. The RBI has staked its claim whenever a digital asset behaves like money or a payment system. SEBI asserts jurisdiction where the token resembles a security or collective investment scheme. The CBDT has seized the taxation space. The FIU-IND has begun pulling exchanges into the anti-money laundering framework. Each of these agencies acts from its own mandate, yet the overlap is obvious.

The danger of such fragmentation is not only confusion for businesses and consumers but also constitutional weakness. We saw this in Internet and Mobile Association of India v. Reserve Bank of India, where the Supreme Court struck down the RBI's 2018 circular that cut crypto exchanges off from banking support.[30] The Court was not endorsing crypto, but it reminded regulators that proportionality is required, and unilateral bans will not survive judicial scrutiny.

India has two choices. It can create a dedicated statutory regulator for VDAs, or it can replicate the GST Council model and establish a permanent inter-agency body. The FSB, in its 2023 global framework for crypto-assets, urged precisely this sort of coordination across regulators.[31] A council comprising RBI, SEBI, CBDT, FIU-IND and the MeitY would not eliminate disagreements, but it would at least provide a forum for consistent policy.

C. VIRTUAL ASSET SERVICE PROVIDER LICENSING

The absence of a licensing system is arguably the single greatest weakness today. Exchanges operate as ordinary companies under the Companies Act with no

28 Swiss Financial Market Supervisory Authority (FINMA), *Guidelines for Initial Coin Offerings* (Feb. 16, 2018).

29 UK Financial Conduct Authority, *Guidance on Cryptoassets*, PS19/22 (July 2019).

30 *Internet and Mobile Association of India v. Reserve Bank of India*, (2020) 10 SCC 274 (India).

31 Financial Stability Board, *Global Regulatory Framework for Crypto-Asset Activities* (July 2023), https://www.fsb.org/2023/07/fsb-global-regulatory-framework-for-crypto-asset-activities/.

sector-specific oversight. This means there are no prudential rules, no governance requirements, and no capital adequacy standards. Consumers are left to trust private assurances.

Global practice is moving in the opposite direction. FATF has made licensing or registration of virtual asset service providers ('VASPs') a global standard.[32] Japan's Payment Services Act obliges exchanges to register with the Financial Services Agency and meet anti-money laundering and consumer protection requirements.[33] Singapore's Payment Services Act, 2019 does the same, creating distinct licences for different categories of activity and enforcing compliance with AML/CFT obligations.[34]

India cannot afford to delay. A licensing regime would immediately filter out weak players, protect consumers, and give credibility to Indian exchanges when dealing with global partners. It would also prevent the sort of failures we have already seen in loosely regulated financial sectors in India.

D. AML/CFT AND KYC COMPLIANCE

Critics of crypto often begin and end with money laundering. Their concerns are not unfounded. FATF's Recommendation 15, updated in 2019, explicitly requires AML/CFT controls for virtual asset service providers.[35] India has taken the first step by designating them as reporting entities under the PMLA in 2023. That move was overdue, but it only covers centralised platforms.

Decentralised finance and self-custodied wallets remain the real challenge. Criminal actors exploit privacy coins, mixers, and cross-chain swaps, as documented in United Nations Office on Drugs and Crime (UNODC) reports.[36] Standard reporting obligations are nearly impossible to enforce here. India needs to invest in blockchain forensic capacity within FIU-IND, building tools and expertise to trace illicit transactions.

There is also scope for wallet-level KYC, especially where wallets interact with fiat on-ramps. This is controversial, but it reflects a pragmatic balance. One cannot police every peer-to-peer transaction, but one can demand accountability when money enters or leaves the banking system.

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32 Financial Action Task Force (FATF), *Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (June 2021), https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Guidance-rba-virtual-assets-2021.html.

33 Payment Services Act, Act No. 59 of 2009 (Japan) (as amended).

34 Payment Services Act 2019, No. 2 of 2019 (Singapore).

35 Financial Action Task Force (FATF), *The FATF Recommendations: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation* (2019), https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf.

36 United Nations Office on Drugs & Crime (UNODC), *Cryptocurrencies and Money Laundering* (2021).

E. CONSUMER PROTECTION

Perhaps the most neglected aspect of India's current regime is consumer protection. Right now, an investor deciding to buy tokens on an exchange sees promotional material but little else. Risk factors are buried in disclaimers. There are no statutory obligations for disclosures of technology, governance, or rights.

Europe's MiCA provides a model. It requires issuers to publish a Key Information Document with plain-language explanations of risks and obligations.[37] Indian law has long recognised the regulator's duty to protect investors. In Narasimha Murthy v. SEBI, the Securities Appellate Tribunal underscored SEBI's responsibility to prevent misrepresentation in financial instruments.[38] Extending the same principle to VDAs is straightforward.

Advertising rules, too, need attention. SEBI's 2022 code for mutual funds insists that risk warnings must be prominent and legible. Adapting this approach for VDA advertising would immediately reduce the incidence of misleading promotions. Until such frameworks are created, consumers will continue to rely on word of mouth and glossy ads, which is a recipe for fraud.

F. TAX REFORMS

The Finance Act introduced one of the harshest VDA tax regimes anywhere. Section 115BBH imposes a 30 per cent tax on all gains, regardless of the holding period. Section 194S imposes a one per cent TDS on every trade. Worse still, losses cannot be offset against gains. CBDT's Circular No. 13 of 2022 clarified procedural questions but did nothing to address the structural problems.[39]

Scholars have already shown why this approach is counterproductive. It has been explained that the combination of high tax and no set-off has driven liquidity overseas and discouraged compliance.[40] The Organisation for Economic Co-operation and Development's (OECD) 2020 report on virtual currency taxation likewise recommended moderate approaches, loss offsets, and the avoidance of punitive withholding.[41]

India should recalibrate. A rational policy would permit loss set-off, apply graded tax rates depending on holding periods, and reduce the TDS to something closer to 0.1 per cent. The goal of taxation should be to integrate VDAs into the financial

37 *Supra* note 25, tit. II.

38 Ketan Parekh v. Securities and Exchange Board of India, SAT Appeal No. 76 of 2006 (India).

39 Central Board of Direct Taxes, Circular No. 13/2022 (June 22, 2022).

40 Tarun Jain, The Taxation of Cryptoassets in India: A Review of Evolving Tax Policy and Law (2024), *Journal of Tax Administration*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5008593.

41 Organisation for Economic Co-operation & Development (OECD), *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues* (2020), https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/tax-policy/flyer-taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.pdf.

system, not to exile them into offshore markets.

G. INNOVATION AND THE ROLE OF SANDBOXES

No matter how carefully designed, rules will lag behind technology. That is why regulatory sandboxes exist. India does have an RBI sandbox framework, introduced in 2019, but it specifically excludes cryptocurrencies. That decision was more about institutional caution than principle.

Other countries have used sandboxes even for crypto. The MAS has run controlled pilots. The UK FCA has done the same. India has GIFT City, which is designed as a hub for financial experimentation. NITI Aayog's Blockchain Strategy Report (2020) even recommended sandboxes for tokenisation and blockchain pilots.[42] A sandbox dedicated to VDAs could allow safe testing of ideas like tokenised bonds, NFT registries, or cross-border payment solutions, while protecting investors with strict caps and reporting.

H. STABLECOINS & CBDC INTERFACE

Stablecoins are a strange category. They are everywhere in crypto markets, yet nobody seems to agree on how stable they really are. Traders use them like a safe harbour, remitters like the speed, and exchanges depend on them for liquidity. But the promise of stability has often been illusory. Terra-Luna's collapse in 2022, which wiped out billions in days, is the clearest proof. Regulators, once burned, are unlikely to take chances again.

The RBI, in its 'Concept Note on CBDC' published in 2022, did not go as far as banning them. In fact, it accepted that stablecoins might exist alongside a digital rupee, though only under strict rules and direct oversight.[43] That was cautious, but not hostile. A few years earlier, the Bank for International Settlements had warned that only fully collateralised, independently audited stablecoins could be considered trustworthy.[44] Additionally, in the United States, the President's Working Group had gone so far as to say stablecoin issuers should essentially be treated like banks.[45] Some thought this extreme, but given how algorithmic coins fared, the logic is not difficult to follow.

For India, the answer seems narrower than it first appears. Fiat-backed stablecoins may be tolerated if redemption rights are guaranteed and audits are pub-

42 NITI Aayog, *Blockchain: The India Strategy* (Jan. 2020), https://www.niti.gov.in/sites/default/files/2020-01/Blockchain_The_India_Strategy_Part_I.pdf.

43 Reserve Bank of India, *Concept Note on Central Bank Digital Currency* (Oct. 2022).

44 Bank for International Settlements (BIS), *Stablecoins: Risks, Potential and Regulation* (2021).

45 President's Working Group on Financial Markets, *Report on Stablecoins* (Nov. 2021), https://home.treasury.gov/news/press-releases/jy0454.

lished regularly. Algorithmic stablecoins, on the other hand, should simply not be allowed. Truth be told, they are closer to speculative experiments than to money. The CBDC itself will only succeed if it is not forced to compete against private tokens that collapse without warning. To put it bluntly, if people lose trust once, it will be hard to rebuild.

I. ENFORCEMENT AND TRANSITION

Rules on paper have limited value unless backed by enforcement. India's record so far has been patchy. The Enforcement Directorate's probe into WazirX in 2022 came only after global pressure, not as a proactive step.[46] That sends the wrong signal: that Indian supervision reacts to crises instead of preventing them.

The International Organisation of Securities Commission's (IOSCO) 2023 recommendations are clear that crypto enforcement has to be international, with cooperation across borders and penalties that align across jurisdictions.[47] Without that, operators just shift to friendlier regimes. India must therefore legislate penalties that are unambiguous, operating without a licence, failing AML obligations, or misleading advertising should all draw specific sanctions.

Still, the Supreme Court's warning in IAMAI v. RBI remains relevant. The Court held that blanket bans are disproportionate and cannot stand, but carefully tailored restrictions are valid.[48] So the approach has to be phased. Maybe a window of twelve to eighteen months for existing exchanges and wallet providers to register, with interim reporting and audits in the meantime. After that, enforcement should be firm, not flexible. Without such a balance, the rules will either be toothless or they will collapse in Court.

V. IMPLEMENTATION ROADMAP AND METRICS

The licensing and taxation reforms proposed above will only be credible if they can be measured. Rules always look impressive on paper, but unless there is a way to check whether they are actually delivering results, they remain abstract promises. That is why an implementation roadmap is necessary, to tie the framework to tangible outcomes. Regulators like to speak in the language of KPIs, but in truth the idea is simple: we need a handful of markers that show whether licensing, consum-

46 Directorate of Enforcement, Press Release on freezing WazirX crypto (WRX/USDT) (Sept. 30, 2022)., https://enforcementdirectorate.gov.in/sites/default/files/latestnews/Press%20release%20E-NUGGETS%20Crypto%20Wazirx%2030-09-2022.pdf.

47 International Organization of Securities Commissions (IOSCO), Policy Recommendations for Crypto and Digital Asset Markets (Nov 2023), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD747.pdf

48 IAMAI v. RBI, supra note 4.

er protection, AML, and tax reforms are working as intended.

The first marker is growth in the licensed sector. If India introduces a proper licensing law, the initial measure of success is whether exchanges, custodians, and wallet providers actually register under it. If numbers rise steadily, it shows that firms are willing to comply rather than leave. The opposite, a decline, would signal that rules are too heavy-handed and pushing players offshore. Alongside registrations, trading volumes on Indian-licensed platforms should be watched. If more liquidity returns home from overseas exchanges, it proves the system is gaining trust.

Next comes investor protection. This is trickier to quantify but still doable. Regulators can track the number of consumer complaints filed in relation to VDAs and, just as importantly, how quickly they are resolved. If complaints fall over time or if resolution times improve, then disclosure norms and advertising restrictions are working. Even a simple consumer survey, run periodically, could capture whether investors feel more informed than before.

Tax compliance is another big one. At present, punitive rules have driven reporting underground. If the regime is recalibrated with loss set-offs and fairer rates, the measure of success is whether more people voluntarily report their crypto income. That can be seen both in higher collections and in the broader base of taxpayers. If collections rise but the number of filers does not, then the policy is only squeezing the same few actors. Real success is when ordinary investors start reporting small gains because they no longer fear punishment.

On AML outcomes, the task is harder. FIU-IND could publish annual statistics on STRs filed by VASPs, what percentage led to follow-ups, and how many translated into prosecutions or seizures. Even the number of officers trained in blockchain forensics could be tracked. It sounds bureaucratic, but building capacity is as important as enforcement.

Finally, foreign capital repatriation will say a lot. Over the past few years, Indian crypto startups have relocated to Singapore or Dubai for clarity. If some of them come back, or if new investment flows into licensed Indian platforms, that is a sign of restored credibility. RBI data on cross-border inflows and filings from licensed firms could make this visible.

The point is not to drown the framework in numbers but to identify a handful of clear indicators: licensed VASPs, trading volumes, complaints, tax compliance, AML reports, and capital inflows. If these lines all move in the right direction, it will prove the framework is more than words.

VI. RISK ANALYSIS AND COUNTER ARGUMENTS

The proposals outlined earlier will not go unchallenged. Critics will argue that virtual digital assets are magnets for laundering, that they destabilise economies, that most ac-

tivity is mere speculation, and that strict rules will drive capital abroad. These concerns are real and must be taken seriously. But the good news is that the same measures described in the framework already provide answers.

Start with AML risk. It is true that crypto has been used for laundering and terror financing. But leaving the sector unregulated does not reduce that risk, it amplifies it. By licensing VASPs, imposing PMLA obligations, and strengthening FIU-IND's forensic capabilities, India gives itself visibility into transactions that would otherwise be opaque. It does not eliminate risk, nothing can, but it creates tools for detection and action.

Then there is systemic risk. Skeptics imagine a crypto collapse spilling into the broader economy. But classification and prudential norms address this. Payment tokens and stablecoins can be kept under RBI oversight with proof of reserves. Security tokens can fall under SEBI. Algorithmic experiments that pose contagion risk can be prohibited. The risk is acknowledged but contained.

The third argument is about speculation and investor harm. It is true that many tokens function like gambling chips, and retail investors have suffered losses. But here too, regulation makes a difference. Disclosure requirements, strict advertising codes, and dispute resolution schemes reduce mis-selling. Rational taxation that encourages reporting instead of flight brings activity into the open. Speculation will never vanish, but its impact can be softened.

Finally, critics worry about capital flight. They say if India regulates too tightly, firms and investors will flee. But experience from other jurisdictions suggests otherwise. Capital prefers clarity to chaos. When rules are transparent, even if strict, serious firms adapt. Already many Indian startups have gone to Singapore and Dubai, not because the rules there are lax but because they are predictable. If India offers a framework that is both firm and clear, some of that capital will return.

So yes, the counterarguments have weight. But none of them prove that regulation is futile. On the contrary, they highlight why proportionate, transparent rules are necessary. Regulation does not erase risk, but it transforms it into something manageable. And that is far better than leaving crime, speculation, and instability to define the market.

VII. CONCLUDING REMARKS

Bringing all these threads together, classification, coordination, licensing, AML, consumer protection, tax reform, sandboxes, stablecoins, enforcement, and participation, what India needs is not a revolution but clarity. Other jurisdictions have already laid down models. The EU with MiCA, Switzerland with FINMA, and Singapore with its Payment Services Act. None of these is perfect, but they prove regulation is possible without killing innovation.

India's mistake would be to lurch between extremes: first ignoring VDAs, then threatening bans, then taxing them heavily, then talking of CBDCs without addressing the rest. A steady, middle course is harder to sell politically, but it is the

only sustainable path. Investors deserve protection, regulators deserve authority, innovators deserve space.

If India manages this balance, it could go beyond domestic needs and set a benchmark for the region. It is not far-fetched to think of India shaping the conversation at the global level. But this will only happen if rules are not just clever on paper but workable in practice. And, to be honest, that will matter more than any slogan about being “crypto-friendly” or “crypto-hostile.”

RETHINKING THE REGULATION OF CRYPTOASSETS IN INDIA

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ABSTRACT

The regulation of virtual digital assets and crypto assets represents one of the most pressing legal and policy challenges of the twenty-first century. In India, the existing framework is marked by fragmentation: taxation is governed by recent amendments to the Income-tax Act, 1961; anti-money laundering measures have been extended under the Prevention of Money Laundering Act, 2002; and judicial precedent has circumscribed the limits of regulatory action under the Constitution. Yet, the absence of a bespoke, comprehensive statutory regime has created uncertainty, deterring investment and innovation in a sector with substantial potential for financial inclusion and technological advancement. This paper proposes a policy approach that seeks to foster the growth of virtual digital assets as a new asset class while safeguarding public interest. Employing doctrinal, comparative, and constitutional analysis, the paper surveys the current Indian legal position, examines international models—including the European Union's Markets in Crypto-Assets Regulation, Japan's Payment Services Act, Singapore's licensing framework, and Australia's custody regime, distilling key lessons for Indian regulation. The paper advances a tripartite framework: (i) enactment of a legislation governing virtual digital asset markets and services to regulate issuance, custody, and trading; (ii) explicit statutory recognition of the Reserve Bank of India's authority over systemic stablecoins; and (iii) reform of the existing tax regime towards a capital-gains-oriented model. The proposed framework is grounded in constitutional proportionality, investor protection, and India's international commitments.

I. INTRODUCTION

The emergence of virtual digital assets ('VDAs'), also referred to as crypto assets, has disrupted conventional paradigms of finance and governance. India, a jurisdiction marked by both its conservative regulatory tradition and burgeoning digital economy, finds itself at a critical juncture. On the one hand, India ranks among the largest retail markets for crypto adoption globally, with an estimated 156 million users by mid-2023.[49] On the other hand, its regulatory response is oscillating from central bank proscription to judicial intervention, and thereafter, to selective statutory measures on taxation and anti-money laundering.

The legal status of VDAs in India, was clarified, albeit partially, in Internet and Mobile Association of India v. Reserve Bank of India ('IAMAI v. RBI').[50] In this seminal judgment, the Supreme Court quashed the Reserve Bank of India's ('RBI') 2018 circular prohibiting entities regulated by it from dealing with crypto businesses, holding the measure disproportionate under Article 19(1)(g) of the Constitution.[51]

49 Chainalysis, The 2023 Geography of Currency Report (2023) 15.

50 Internet and Mobile Association of India v. Reserve Bank of India, (2020) 10 SCC 274.

51 *Id*., [6.153] – [6.155].

While this restored access to banking channels, the Court refrained from conferring legitimacy to crypto assets themselves, thereby leaving open a regulatory vacuum.

Subsequent legislative action has largely targeted the risk vectors of crypto assets rather than its systemic integration. The Finance Act, 2022 ('Finance Act', introduced a bespoke definition of "virtual digital assets" into the Income Tax Act, 1961 ('Income-Tax Act'), and imposed a flat 30% tax on gains, alongside a 1% Tax Deduction at Source ('TDS') on transfers.[52] In parallel, a notification under the Prevention of Money Laundering Act, 2002 ('PMLA') in March 2023 designated crypto service providers as "reporting entities," thereby subjecting them to know-your-customer ('KYC') and suspicious transaction reporting obligations. [53]

Despite these developments, India lacks a comprehensive framework akin to the European Union's ('EU') Markets in Crypto-Assets Regulation ('MiCA'), which establishes a harmonized licensing and disclosure regime. [54] Instead, India's trajectory remains fragmented: the RBI maintains deep scepticism particularly towards stablecoins, which it views as a threat to monetary sovereignty while the Securities and Exchange Board of India ('SEBI') has signalled openness to regulate market-related aspects of VDAs under a multi-regulator model.[55] This regulatory divergence reflects an underlying tension: how to reconcile innovation with investor protection and systematic stability.

The absence of a clear policy architecture poses multiple risks. First, regulatory uncertainty drives capital and talent offshore, undermining India's stated ambition to be a global digital economy leader. Second, consumer protection remains weak; high-profile exchange failures and mis-selling scandals abroad highlight the perils of opaque custody and conflicts of interest. Third, excessive taxation—especially the 1% TDS requirement—has impaired domestic liquidity, incentivising informal peer-to-peer trading. [56] Finally, India's G20 leadership and endorsement of the International Monetary Fund – Financial Stability Board ('IMF-FSB') roadmap in 2023 underscore its international obligations to implement consistent and risk-sensitive frameworks. [57]

A combination of these reasons motivates a relook at Indian jurisprudence on the novel approach to regulation of VDAs, including from a policy-based perspective, to determine whether a transition which is necessary could be achieved. Such an exercise has not been carried out, to this paper's extent yet.

To forward the same, Part II of this paper will flesh out the legal and practical position surrounding VDAs and its related regulations in India to contextualize our

52 Finance Act 2022, §2(47A) (inserting definition of "virtual digital asset" into Income-tax Act 1961).

53 Ministry of Finance (Department of Revenue), Notification S.O. 1072(E), 7 March 2023.

54 Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on Markets in Crypto-assets, [2023] OJ L150/40.

55 Reuters, 'India's SEBI Favors Multi-Regulator Approach to Cryptoassets' (16 May 2024) available at https://www.reuters.com (Last accessed 7 September 2025).

56 NASSCOM, Impact of TDS on Virtual Digital Asset Markets in India (Policy Brief, 2023) 8–9.

57 G20 Leaders' Declaration, New Delhi, 9–10 September 2023, ¶47.

discussion. Part III will continue the discourse by providing an overview of the regulation of VDAs in major jurisdictions. Lessons drawn from this portion will assist in drawing up a structure for a future Indian model that allows the regulation of VDAs to rest on. Part IV will forward some policy-based considerations for allowing the regulatory model for crypto assets while assuaging any concerns that may be present. This Part will also provide the suggested framework model. This Part will also provide the constitutional and public policy implications of such a framework and will underscore the imperative of adopting a pro-growth, risk-aware approach to VDAs. Part V will provide a few concluding thoughts.

II. CURRENT LEGAL POSITION OF VIRTUAL DIGITAL ASSETS IN INDIA

The Supreme Court's decision in IAMAI v. RBI remains the lodestar in determining the constitutional position of VDAs.[58] In April 2018, the RBI issued a circular prohibiting entities regulated by it—banks and non-bank financial institutions—from dealing in or providing services to entities engaged in the trading or settlement of crypto assets. [59] This effectively severed crypto exchanges from banking infrastructure, precipitating widespread business closures.

Challenged under Article 19(1)(g), the restriction was held disproportionate. The Court accepted that the RBI, as India's monetary authority, had the competence to regulate activities that could impact the payment system or financial stability. [60] However, it found that the RBI's measure lacked empirical evidence of actual harm caused by crypto assets to the regulated entities.[61] Invoking the proportionality test laid down in Modern Dental College v. State of Madhya Pradesh,[62] the Court held that the RBI's action failed the necessity and balancing prongs, given that less restrictive alternatives were available.[63]

While this judgment restored access to banking services, it did not confer legality or recognition upon VDAs. The Court emphasized that Parliament and the executive retained the authority to legislate or regulate crypto assets more comprehensively.[64] Thus, the judicial position is one of negative liberty i.e., the absence of prohibition rather than affirmative recognition.

The Finance Act marked the first instance of statutory recognition of VDAs by the

58 *Id*., 2, 3.

59 RBI, Circular DBR.No.BP.BC.104/08.13.102/2017-18, 'Prohibition on dealing in Virtual Currencies' (6 April 2018).

60 *supra* note 2 [6.48].

61 *Id*., [6.153].

62 Modern Dental College and Research Centre v. State of Madhya Pradesh, (2016) 7 SCC 353.

63 *supra* note 2 [6.155].

64 *Id*., [6.156].

insertion of section 2(47A) into the Income Tax Act; the legislature defined "virtual digital assets" as: "(a) any information, code, number or token (not being Indian currency or foreign currency), generated through cryptographic means providing a digital representation of value capable of being transferred, stored or traded electronically".[65] This broad definition encompasses cryptocurrencies, non-fungible tokens ('NFTs'), and similar digital instruments, subject to specific exclusions notified by the Central Government.[66]

The tax regime for VDAs is punitive. Section 115BBH of the Income Tax Act imposes a flat 30 % tax on income from the transfer of a VDA, without allowing set-off of losses against other income heads or carry-forward of losses.[67] Section 194S mandates a 1% TDS on payments made for the transfer of a VDA, above a specified monetary threshold.[68] Gifts of VDAs are also taxable in the hands of recipients under Section 56(2)(x),[69] the clarifications issued by the Central Board of Direct Taxes ('CBDT') in 2022 and 2023 excluded certain items from the scope of "VDAs" for instance, loyalty reward points, mileage points, and in-game tokens not tradable outside the platform.[70] However, the high effective tax incidence, coupled with the TDS requirement, has substantially reduced onshore liquidity, pushing volumes to offshore and peer-to-peer markets.[71]

In March 2023, the Ministry of Finance notified VDA service providers ('VASPs') as 'reporting entities' under the PMLA.[72] The scope of covered activities includes: exchange between VDAs and fiat currencies, exchange between one or more forms of VDAs, transfer of VDAs, safekeeping or administration of VDAs, and participation in and provision of financial services related to an issuer's offer or sale of a VDA;[73] by virtue of this notification, VASPs must comply with the full range of obligations applicable to banks and other financial intermediaries: customer due diligence (KYC), record-keeping, reporting of suspicious transactions, and registration with the Financial Intelligence Unit – India ('FIU-IND').[74]

Non-compliant offshore exchanges servicing Indian residents are subject to blocking measures and enforcement action. Indeed, in 2024, FIU-IND initiated proceedings against several global exchanges and required them to register locally.[75] This measure aligns India with the Financial Action Task Force ('FATF') Recommendation 15, which requires countries to regulate virtual asset service providers

65 Income-tax Act 1961, §2(47A), inserted by Finance Act 2022.

66 Ministry of Finance, Notification No. 75/2022/F. No. 370142/10/2022-TPL (30 June 2022).

67 Income-tax Act 1961, §115BBH.

68 *Id*., §194S.

69 *Id*., §56(2)(x).

70 CBDT, Circular No. 13 of 2022 (22 June 2022).

71 *supra* note 8.

72 Ministry of Finance (Department of Revenue), Notification S.O. 1072(E) (7 March 2023).

73 *Id*., 24.

74 Prevention of Money Laundering Act 2002, §2(1).

75 FIU-IND, Press Release, 'Registration of VDA Service Providers under PMLA' (December 2023).

for anti-money laundering and counter-terrorist financing ('AML' / 'CFT') purposes.[76] However, enforcement challenges persist in cross-border contexts, where unlicensed platforms may still solicit Indian users. Given the volatility and speculative nature of VDAs, consumer protection concerns have animated regulatory intervention in advertising. In 2022, the Advertising Standards Council of India ('ASCI') issued guidelines requiring that all VDA-related advertisements include a prominent disclaimer: "Crypto products and NFTs are unregulated and can be highly risky. There may be no regulatory recourse for any loss from such transactions." [77]

The guidelines further prohibit the use of the words "currency," "securities," "custodian," or "depositories" in crypto advertisements, and impose restrictions on celebrity endorsements.[78] While these guidelines lack the force of statute, they have been widely adopted and are often enforced through media self-regulation and consumer complaints.

The Digital Personal Data Protection Act, 2023 ('DPDP Act') represents a significant reform in India's data governance framework.[79] While not crypto-specific, its provisions are directly relevant to VASPs, which handle sensitive KYC data and financial information. The DPDP Act mandates data fiduciaries to process personal data only for lawful purposes, with consent or legitimate grounds, and to ensure purpose limitation, data minimization, and reasonable security safeguards.[80]

Cross-border transfer of personal data is permitted only to countries notified by the Central Government as "trusted jurisdictions",[81] which may constrain global VASPs operating in India. Once fully operationalized, the DPDP Act will impose heightened compliance obligations on exchanges, custodians, and wallet providers, particularly with respect to breach notifications and user rights.

Although its 2018 circular was quashed, the RBI has continued to caution against the risks of crypto assets. Successive Financial Stability Reports have described them as "a clear danger," citing volatility, illicit-finance risks, and systemic spillovers from stablecoins.[82] In 2023, the RBI's Deputy Governor reiterated that private cryptocurrencies have "no underlying value" and cannot be accorded currency status. [83]

In contrast, the RBI has actively piloted the Central Bank Digital Currency ('CBDC') or e -rupee (e₹), emphasising that this official digital alternative obviates the need for private stablecoins.[84] The RBI's opposition to stablecoins thus reflects its concern for monetary sovereignty and capital control. This patchwork framework has addressed specific risks but has not created a comprehensive market architecture

76 FATF, Updated Guidance for a Risk-Based Approach to Virtual Assets and VASPs (October 2021).

77 ASCI, Guidelines for Advertising of Virtual Digital Assets and Linked Services (February 2022) ¶3.

78 *Id*., ¶¶4–7.

79 Digital Personal Data Protection Act 2023, No 22 of 2023.

80 *Id*., §§4–8.

81 *Id*., §16.

82 RBI, Financial Stability Report (June 2022) 46.

83 RBI Deputy Governor T Rabi Sankar, Speech at IMF Conference, April 2023.

84 RBI, Concept Note on Central Bank Digital Currency (October 2022) 6–8.

for issuance, trading, custody, or stablecoins. It is therefore inadequate to foster VDAs as a legitimate and growth-oriented asset class, the resolution of this challenge will be addressed in Part IV of this paper.

III. REGULATORY APPROACHES – A GLOBAL PERSPECTIVE

This section of the paper will provide a comparative analysis of regulations of VDAs in common law nations that have had a dedicated discussion on this point.[85] Despite the variance in regulation between common and civil law nations noted above,[86] it is not necessary to carry out an analysis of the civil law nations here. This is so, as India, by virtue of being a common law nation, [87] does not take inspiration from civil law countries while rethinking settled positions of law.

Naturally then, only the jurisdictions discussed below could provide encouragement for India to change its position and guide the specificities of such a potential change. This section aims to serve our legislature if they choose to discuss the regulation of virtual digital assets, and as an ancillary objective, it can act as a starting point for our legislature looking to establish trusts.

A. THE EUROPEAN UNION

The EU has emerged as the most ambitious regulator of VDAs through the MiCA, adopted in 2023.[88]

MiCA creates a uniform framework for the issuance, offering, and admission to trading of crypto assets across all EU member states, thus preventing regulatory fragmentation within the single market. MiCA applies to three categories of assets: asset-referenced tokens ('ARTs'), e-money tokens ('EMTs'), and other crypto assets (such as utility tokens).[89] It expressly excludes security tokens already covered under the Markets in Financial Instruments Directive ('MiFID II'). [90] Issuers must

85 It should be noted that European Union, Japan and UAE are traditionally a civil law country but has been inspired by common law and is considered a mixed-law nation now. For discussion on this point, *see* "Civil Law and Common Law: Two Different Paths Leading to the Same Goal" by Caslav Pejovic (2001), *Victoria University of Wellington Law Review*

86 *See* Part I on "Introduction".

87 Mahendra Pal Singh & Niraj Kumar, THE INDIAN LEGAL SYSTEM: AN ENQUIRY, Chapter 1, xxxi–lvi (Oxford Academic, 2019).

88 Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on Markets in Crypto-assets [2023] OJ L150/40.

89 MiCA, art 3(1)

90 Directive 2014/65/EU (MiFID II).

publish a detailed whitepaper containing technical and risk disclosures, subject to notification to the competent authority.[91] The whitepaper must also include sustainability disclosures concerning the environmental impact of consensus mechanisms, reflecting the EU's Green Deal priorities.[92]

MiCA requires crypto asset service providers ('CASPs')—including exchanges, custodians, and portfolio managers—to obtain authorization from the competent authority of a member state.[93] Once licensed, CASPs benefit from an EU "passport," enabling cross-border provision of services.

ARTs and EMTs are subject to stringent reserve and governance requirements. EMTs, functionally similar to e-money, must be issued only by credit institutions or e-money institutions.[94] The European Banking Authority ('EBA') is empowered to supervise "significant" stablecoins.[95] MiCA introduces a regime prohibiting insider trading, market manipulation, and unlawful disclosure of inside information in crypto asset markets.[96]

MiCA represents a comprehensive, horizontal framework: it addresses issuance, service provision, and market integrity simultaneously. For India, MiCA illustrates the utility of a dedicated statute integrating multiple regulators—rather than piecemeal measures under taxation, AML, or consumer law.

Though much discussion could be had about India's position as a financial regulator solely using the finding above, this paper is only concerned with the regulation of virtual digital assets. To conclude, crypto assets are wholly regulated in the EU. However, it should be noted that the regulation does not hinder the potential of the markets or innovation while also protecting the investors, consumers and maintaining the standards of the market through a dedicated statute integrating multiple regulators rather than different statutes.

The above comparison attempted to provide a model for a regulatory framework in India. However, other decisions and models do too, as has been discussed later in the paper.

B. THE UNITED KINGDOM

The United Kingdom ('UK') has adopted a phased, functional approach to regulating crypto assets. The Financial Services and Markets Act 2023 ('FSMA 2023') empowered HM Treasury to bring crypto assets within the regulatory perimeter of financial services legislation.[97] Since 2020, crypto asset exchange providers and

91 *supra* note 41, arts 5–7.

92 *Id*., art 6(9).

93 *supra* note 42, arts 53–54.

94 *supra* note 42, arts 48–52.

95 *supra* note 42, art 95.

96 *supra* note 42, arts 92–94.

97 Financial Services and Markets Act 2023 (UK), §29.

custodian wallet providers have been required to register with the Financial Conduct Authority ('FCA') for anti-money laundering purposes.[98] The FCA maintains a public register of approved firms, while non-compliant firms are prohibited from operating.

In 2023, the FCA introduced stringent financial promotion rules, classifying crypto assets as "restricted mass-market investments."[99] Firms must ensure fair, clear, and not misleading communications, and provide standardized risk warnings such as: "Don't invest unless you're prepared to lose all the money you invest." [100]

The UK Treasury has proposed bringing stablecoins used as means of payment within the regulatory perimeter as a first step, with the Bank of England supervising systemic stablecoin arrangements.[101]

Consultations in 2023 indicated the government's intent to extend regulation to a broader range of crypto asset activities, including lending, staking, and custody. [102]

The UK's phased strategy reflects caution; it prioritizes consumer protection and AML while deferring comprehensive rules until further market development. This sequencing may be instructive for India, where capacity constraints argue for a staged regulatory rollout.

C. THE UNITED STATES

The United States ('US') presents the opposite extreme: a fragmented, overlapping regulatory landscape driven by multiple federal and state authorities. The Securities and Exchange Commission ('SEC') treats many tokens as "investment contracts" under the Howey test, thereby subjecting them to securities regulation. [103] This has led to high-profile enforcement actions against exchanges such as Coinbase and Binance for unregistered securities offerings. [104]

The Commodity Futures Trading Commission ('CFTC') claims jurisdiction over crypto derivatives and has also asserted that Bitcoin and Ether are commodities.[105] This dual-claim creates regulatory uncertainty. The Financial Crimes Enforcement Network ('FinCEN') requires crypto exchanges to register as money services busi-

98 Money Laundering and Terrorist Financing (Amendment) Regulations 2019 (UK), SI 2019/1511.

99 FCA, Policy Statement PS23/6: Financial Promotion Rules for Cryptoassets (June 2023).

100 *Id*., Appendix 1.

101 HM Treasury, UK Regulatory Approach to Cryptoassets and Stablecoins: Consultation (January 2021) 12.

102 HM Treasury, Future Financial Services Regulatory Regime for Cryptoassets: Consultation (February 2023).

103 SEC v. W.J. Howey Co., 328 US 293 (1946).

104 SEC v. Coinbase, Inc., Complaint, SDNY, No 1:23-cv-04738 (6 June 2023).

105 CFTC v. McDonnell, 287 F Supp 3d 213 (EDNY 2018).

nesses and comply with AML rules.[106]

New York's "BitLicense" regime mandates licensing for crypto businesses, imposing stringent capital, cybersecurity, and AML requirements.[107] Other states, such as Wyoming, have created more permissive regimes.

The US model demonstrates the risks of regulatory incoherence. While robust enforcement deters misconduct, the absence of a harmonized statute hampers innovation and drives businesses offshore. India can avoid such pitfalls by ensuring that multiple regulators act under a unified legislative mandate.

D. SINGAPORE

Singapore has positioned itself as a global fintech hub while carefully mitigating risks through the Monetary Authority of Singapore ('MAS'). Since 2020, the Payment Services Act, 2019 has required licensing for digital payment token ('DPT') service providers, including exchanges and custodians. [108] The Act imposes AML/CFT requirements consistent with FATF standards. MAS issued guidelines in 2022 restricting the public promotion of DPT services.[109] Advertisements cannot trivialize risks or be placed in public venues; they are limited to service providers' websites and official apps.

In 2023, MAS finalized a framework for stablecoin regulation. Only issuers of single-currency stablecoins pegged to the Singapore dollar or G10 currencies are permitted.[110] Issuers must maintain reserve assets in low-risk, highly liquid instruments, subject to independent audits. Singapore emphasizes functional regulation. The MAS applies the same risk-based principles to traditional finance and crypto, avoiding regulatory arbitrage.[111] Singapore illustrates how a small jurisdiction can balance innovation with systemic safeguards, offering India a model for sandbox-driven development.

E. UNITED ARAB EMIRATES

For India-facing relevance, the United Arab Emirates ('UAE') is notable given the large Indian diaspora and cross-border remittances. The UAE subjects VASPs to AML/CFT obligations under federal law, consistent with FATF standards. [112] The Dubai Virtual Assets Regulatory Authority ('VARA') issues licences for exchanges

106 FinCEN, Guidance on Virtual Currencies (2019).

107 23 NYCRR Part 200 (New York BitLicense Regulation).

108 Payment Services Act 2019 (Singapore), No 2 of 2019.

109 MAS, Guidelines on Provision of Digital Payment Token Services to the Public (January 2022).

110 MAS, MAS' Stablecoin Regulatory Framework (August 2023).

111 Ravi Menon, 'Singapore's Approach to Crypto Regulation' (MAS Speech, November 2021).

112 UAE Cabinet Decision No. 10 of 2019 on AML and CFT.

and custodians, with tailored requirements depending on the scale of operations.[113] The Abu Dhabi Global Market (ADGM) has a comprehensive framework treating crypto assets as commodities, supervised under its Financial Services Regulatory Authority.[114] The UAE approach illustrates how specialised regulatory authorities can foster innovation hubs while ensuring compliance, an idea worth exploring in India through financial Special Economic Zones.

F. JAPAN

Japan was one of the first jurisdictions to enact statutory regulation of crypto assets, prompted by the collapse of the Mt. Gox exchange in 2014.[115] In 2016, Japan amended the Payment Services Act ('PSA') to define "crypto assets" (then termed "virtual currencies") as property value that can be used as a means of payment and transferred electronically.[116] This gave crypto assets legal recognition as a medium of exchange, though not as legal tender.

The PSA requires all crypto asset exchanges operating in Japan to register with the Financial Services Agency ('FSA')[117] Exchanges must meet capital adequacy, cybersecurity, and segregation-of-assets requirements.[118] Following high-profile hacks, such as the Coincheck theft in 2018, the FSA authorised the Japan Virtual Currency Exchange Association ('JVCEA') as a self-regulatory organisation.[119] The JVCEA issues binding rules on custody, leverage limits, and listing standards.

In 2022, Japan passed legislation requiring stablecoins to be issued only by licensed banks, trust companies, or registered money transfer agents.[120] This is among the most conservative approaches globally, prioritising financial stability. Japan's model illustrates the value of statutory clarity combined with delegated self-regulation. For India, it highlights how empowering industry associations under state supervision can build trust.

G. AUSTRALIA

Australia has adopted a principle-based approach, emphasising functional classi-

113 Dubai Law No. 4 of 2022 on the Regulation of Virtual Assets.

114 ADGM FSRA, Guidance – Regulation of Crypto Asset Activities in ADGM (2019).

115 Financial Services Agency (Japan), Report on the Problems Caused by the Bankruptcy of Mt. Gox (2014).

116 Payment Services Act 2009 (Japan), as amended by Act No. 62 of 2016, art 2(5).

117 ibid art 63-2.

118 ibid art 63-10.

119 FSA, 'Designation of Japan Virtual Currency Exchange Association as a Certified Association' (24 October 2018).

120 Act No. 34 of 2022, amending the Payment Services Act (Japan).

fication and broad application of existing financial services law. Under the Corporations Act 2001 ('Corporations Act'), crypto assets may fall within the definition of "financial products" if they represent investment contracts, derivatives, or interests in managed investment schemes.[121] Where they qualify, service providers must hold an Australian Financial Services Licence ('AFSL').[122] Since 2018, digital currency exchanges must register with the Australian Transaction Reports and Analysis Centre ('AUSTRAC'), implement KYC measures, and report suspicious transactions.[123]

The Australian Securities and Investments Commission ('ASIC') has issued guidance clarifying the obligations of crypto asset issuers and intermediaries under the Corporations Act.[124] ASIC has also taken enforcement action against misleading promotions and unlicensed operations.[125] In 2022, the Treasury launched consultations on a "token mapping exercise" to classify different types of crypto assets and tailor future legislation.[126] This approach demonstrates openness to innovation, ensuring that regulatory interventions are evidence-based and technology-neutral.

Australia's model demonstrates how general financial services law can be flexibly adapted to crypto assets, pending the development of bespoke legislation. For India, this suggests that immediate reforms need not await a comprehensive statute: existing laws can be interpreted purposively.

IV. TOWARDS THE REGULATION OF VDAs IN INDIA

Parts II and III above have provided a premise to suggest a framework towards the regulation of VDAs in India. It should be noted that this section, or this paper, is not a critique of the current regulation. The author believes that the regulation is legally sound and correctly applied to regulate virtual digital assets prevailing now. This portion looks to advocate for a legislative change (amendment to the regulatory framework) in the current position of Indian law. To begin, it is relevant to look at the policy reasons to regulate VDAs in India.

A. WHY IS THERE A NEED FOR BETTER REGULATION?

Despite incremental reforms, India's regulatory approach to VDAs remains frag-

121 Corporations Act 2001 (Cth) (Australia) §763A.

122 *Id*., §911A.

123 Anti-Money Laundering and Counter-Terrorism Financing Amendment Act 2017 (Cth) (Australia).

124 ASIC, INFO 225: Initial Coin Offerings and Crypto-assets (May 2019).

125 ASIC v. Finder Wallet Pty Ltd [2022] FCA 1279.

126 Australian Treasury, Token Mapping Consultation Paper (December 2022)

mented and reactive. The absence of a dedicated statute or coherent regulatory framework has created uncertainty for investors, businesses, and regulators alike. This Part identifies key policy challenges facing India in designing a future-ready regime for VDAs.

India currently regulates VDAs through sectoral interventions such as taxation under the Income-tax Act, AML oversight through the PMLA, advertising restrictions via ASCI, and RBI cautionary statements. However, this patchwork approach has produced regulatory gaps and overlaps. No current statute governs issuance of tokens, licensing of exchanges, or prudential norms for custodians. Stablecoins remain outside any bespoke regulatory framework.

Exchanges must comply with both FIU-IND registration and SEBI's general investor protection norms, but without clarity on jurisdictional primacy. Judicial pronouncements such as IAMAI v. RBI affirm the RBI's competence but do not delineate how this interacts with SEBI's securities mandate or the Ministry of Finance's taxation powers. This fragmentation contrasts sharply with the EU's MiCA model, which integrates multiple policy goals under one statute. Unless harmonized, India risks regulatory arbitrage, with businesses exploiting unclear mandates to avoid compliance.

The 30% tax on VDA gains and the 1% TDS have had adverse market effects. Liquidity has shifted offshore, with Indian users increasingly relying on foreign exchanges through virtual private networks (VPNs) and peer-to-peer ('P2P') transactions. [127] High taxation, while intended to discourage speculative trading, undermines India's ability to monitor transactions and collect revenue. The punitive approach creates a paradox: it drives activity underground, reducing compliance, while failing to deter genuine speculative behaviour.

By contrast, jurisdictions like Australia and Singapore have adopted neutral tax regimes, treating VDAs under capital gains or corporate tax frameworks without punitive surcharges. This supports innovation while ensuring revenue capture.

The RBI has consistently flagged systemic concerns: volatility, spillovers to the banking sector, and monetary sovereignty risks from stablecoins. [128] These concerns are valid, but the absence of a clear regulatory perimeter leaves them unaddressed. Stablecoins, in particular, could disrupt India's capital control framework under the Foreign Exchange Management Act, 1999 ('FEMA'). A dollar-pegged stablecoin widely adopted in India could erode the rupee's role in domestic payments. Without bespoke legislation akin to Japan's or the EU's stablecoin regimes, India risks a regulatory vacuum in this critical domain.

While bringing VDA service providers under the PMLA aligns India with FATF standards, enforcement capacity remains limited. FIU-IND has only recently begun targeting offshore exchanges, and compliance rates among domestic players are

127 *supra* note 8.

128 RBI, Financial Stability Report (June 2022) 46.

uneven. [129]

Cross-border enforcement is particularly challenging. Offshore exchanges may serve Indian users without maintaining a local presence, rendering PMLA oversight ineffective. India has yet to establish robust mechanisms for international supervisory cooperation, unlike the EU, where the EBA coordinates across member states.

The speculative nature of crypto assets has exposed Indian consumers—particularly young retail investors—to significant risks. While ASCI's advertising guidelines mandate disclaimers, they lack statutory teeth.

Investor recourse mechanisms are also absent. In the event of exchange collapses or fraud (as seen in the FTX collapse globally), Indian investors have no statutory protection akin to securities market investors under SEBI's jurisdiction.

This raises broader concerns under Article 21 of the Constitution, where the right to life includes the right to informational self-determination and freedom from economic exploitation. Without a coherent consumer protection statute, India risks undermining financial inclusion.

The DPDP Act imposes obligations on VDA service providers but creates uncertainty regarding cross-border data flows. Since exchanges often store KYC and transaction data in offshore servers, restrictions on data transfer could disrupt operations.

Moreover, crypto assets are inherently transnational. Transaction data often resides on decentralized, global ledgers. Reconciling this with India's emphasis on data localization presents a policy conundrum: how to ensure supervisory access without stifling innovation. Multiple institutions claim jurisdiction such as RBI (monetary stability and payment systems), SEBI (securities-like tokens), Ministry of Finance (taxation, AML notifications), MeitY (blockchain innovation). This institutional pluralism has degenerated into turf wars, with each regulator asserting competence without clear statutory allocation. Such fragmentation undermines policy coherence and deters foreign investment. In contrast, Singapore's MAS and Japan's FSA offer single-window regulation, streamlining compliance. India must confront whether to centralize authority in one regulator or establish a new, specialised digital assets authority.

Another challenge is striking the right balance between technological neutrality (to future-proof regulation) and specificity (to address crypto's unique risks). Overly technology-specific laws may become obsolete, while vague, principle-based rules may leave investors unprotected. Australia's "token mapping" exercise offers a middle path: classifying tokens by function (payment, utility, investment) and tailoring obligations accordingly. India must adopt a similar taxonomy to avoid both under- and over-regulation.

India, during its G20 presidency (2023), committed to implementing the IMF-FSB synthesis paper on crypto asset regulation. [130] This requires international coordina-

129 FIU-IND, Press Release, 'Registration of VDA Service Providers under PMLA' (December 2023).

130 IMF–FSB, Synthesis Paper: Policies for Crypto-Assets (September 2023).

tion on standards for stablecoins, cross-border payments, and global AML frameworks. However, India's current punitive taxation and fragmented oversight are at odds with its ambition to be a leader in global fintech governance. Unless India aligns domestic policy with G20 commitments, it risks marginalization in global standard-setting.

B. POLICY RECOMMENDATIONS FOR REGULATION OF CRYPTO ASSETS IN INDIA

A calibrated policy framework for VDAs in India must balance innovation, investor protection, financial stability, and international commitments. Drawing from comparative models and India's constitutional and economic context, this section proposes a comprehensive roadmap.

1. ENACTMENT OF A DEDICATED STATUTE FOR THE REGULATION AND DEVELOPMENT OF VDAS

India should move beyond fragmented regulation towards a single, comprehensive statute like a Virtual Digital Assets (Regulation and Development) Act ('VDARDA').

Key features should include, a clear definitions and taxonomy, adopt a functional classification of VDAs (payment tokens, investment tokens, utility tokens), akin to Australia's token mapping exercise, [131] distinguish stablecoins from speculative crypto assets to allow differentiated regulation, regulatory perimeters such as empowering SEBI to regulate investment-type tokens, empowering RBI to regulate stablecoins and payment-linked VDAs, empowering FIU-IND to oversee AML compliance across the sector, establishing a Digital Asset Coordination Council ('DACC') chaired by the Ministry of Finance to resolve jurisdictional overlaps, licensing regime for VASPs, mandatory registration and licensing with clear capital adequacy, governance, and disclosure norms, prudential requirements for custodians, including segregation of client assets, insurance, and robust cybersecurity standards.

Stablecoins present unique risks to monetary sovereignty and financial stability. India should adopt a model combining Japan's and Singapore's approaches, where under RBI Oversight, all INR-linked stablecoins must be issued only by licensed entities under RBI supervision, for backing and reserves, require 1:1 backing with high-quality liquid assets, held with regulated custodians, for disclosure, there should be mandatory monthly reserve audits. For foreign currency stablecoins, the legislature should ideally prohibit or strictly cap circulation to protect against dollarisation, while allowing cross-border trade use under FEMA.

Such an approach preserves the rupee's centrality while enabling safe innovation

131 Australian Treasury, Token Mapping Consultation Paper (2022) 5.

in tokenised payments.

India's current punitive tax regime is counterproductive. A reformed framework should incorporate rationalized tax rates aligning VDA taxation with capital gains tax rates applicable to securities, eliminating the flat 30% rate, reducing TDS, where we can replace the 1% TDS with a reporting-based system (e.g., quarterly disclosures by exchanges), to reduce liquidity constraints, have a GST clarity, treating exchange services as financial intermediation under GST, with explicit exemptions for peer-to-peer transactions to avoid double taxation. This would support compliance while retaining revenue collection.

Mandatory risk disclosures which would require standardised risk warning templates for all VDA offerings, enforceable under statute (not voluntary guidelines), investor redressal mechanism, establishing a statutory ombudsman for VDAs, modelled on SEBI's SCORES system, to provide timely redress, compensation funds where a "VDA Investor Protection Fund," could be created financed by VASP levies, to compensate retail investors in cases of fraud or exchange insolvency.

Strengthen FIU-IND by expanding staffing, technological capacity, and AI-based monitoring of blockchain transactions, cross-border cooperation, where we enter into supervisory memoranda of understanding ('MoUs') with MAS (Singapore), FCA (UK), and other major regulators for data-sharing and joint enforcement, travel rule implementation, mandating VASPs to comply with FATF's "travel rule," requiring sender and recipient details to accompany transactions.

Data localisation with flexibility, where we permit cross-border transfers subject to "adequacy" or "safe harbour" frameworks, to avoid operational bottlenecks, cybersecurity standards, where ISO/IEC 27001 certification are mandated and regular penetration testing for all licensed VASPs, privacy-preserving supervision, where individuals are encouraged for the use of zero-knowledge proofs and blockchain analytics tools to balance data privacy with supervisory access.

To avoid turf wars, India should adopt a hybrid regulatory model, where there is a Digital Assets Regulatory Authority ('DARA') which will be a specialised authority to license and supervise VASPs, set prudential norms, and coordinate with SEBI, RBI, and FIU-IND, an Inter-Regulatory Coordination Committee ('IRCC') which will be formalised under statute, with quarterly meetings, chaired by the Ministry of Finance, to resolve jurisdictional conflicts, an Advisory Council on Innovation, comprising industry experts, technologists, and academics to advise DARA on emerging risks and opportunities, this ensures both specialisation and coordination, without duplicating mandates.

To foster responsible innovation, there needs to be a regulatory sandbox where there is expansion of the RBI and SEBI sandboxes to cover VDAs, allowing limited-scale testing of new products with relaxed compliance, Incentives for Web3 Startups by offering tax holidays or grants for blockchain research and development and encourage tokenisation of real-world assets under regulated frameworks, CBDC Interoperability where there is promotion of interoperability between the RBI's Digital Rupee and regulated VDA platforms to enhance payment efficiency.

India must anchor its framework within global standards, while safeguarding domestic priorities. The policy must incorporate FATF recommendations on AML/CFT, adopt IMF-FSB synthesis paper principles for stability, Leverage G20 commitments to shape emerging global norms, positioning India as a rule-maker rather than a rule-taker.

Any statute should embody the following principles, technological neutrality, where we should avoid specifying technologies (e.g., blockchain vs. distributed ledger technology), focusing instead on functions, proportionality: balancing regulatory burdens with risks posed by specific classes of assets, clarity and accessibility ensuring that obligations are comprehensible to startups as well as large institutions, future-proofing, incorporating delegated legislation powers for regulators to adapt quickly to technological shifts.

2. CONSTITUTIONAL AND PUBLIC POLICY CONSIDERATIONS

A policy framework for virtual digital assets (VDAs) must be assessed against India's constitutional commitments and broader public policy imperatives. The proposed reforms should be within the constitutional right to trade, proportionality doctrine, and state obligations to balance innovation with stability and investor protection.

Article 19(1)(g) of the Constitution guarantees the freedom to practice any profession or to carry on any trade, business, or occupation.[132] Restrictions on cryptoasset businesses, whether through outright prohibitions or punitive taxation—implicate this right.

In Internet and Mobile Association of India v. RBI, [133] the Supreme Court struck down the RBI's 2018 circular prohibiting banks from servicing crypto exchanges, holding that the measure disproportionately restricted the right to trade in the absence of empirical evidence of harm. This judgment underscores that while regulation is permissible, blanket prohibitions are constitutionally infirm unless justified by compelling state interests.

The proposed framework aligns with this principle by regulating rather than prohibiting VDAs. It preserves the right to trade subject to reasonable safeguards, ensuring constitutional compatibility. The Supreme Court has consistently applied the doctrine of proportionality to test restrictions on fundamental rights.[134] A valid restriction must satisfy four prongs: (i) legality; (ii) legitimate aim; (iii) necessity; and (iv) balancing.

Applying these prongs to VDA regulation, Legality, there should be a dedicated statute (VDARDA) providing clear legal authority, avoiding ad hoc executive measures, Legitimate Aim should be of protecting investors, preventing financial crime,

132 Constitution of India, art 19(1)(g).

133 Internet and Mobile Association of India v. Reserve Bank of India (2020) 10 SCC 274.

134 Modern Dental College and Research Centre v. State of Madhya Pradesh (2016) 7 SCC 353.

and safeguarding monetary stability constitute legitimate state objectives, necessity of regulatory frameworks, rather than prohibitions, are the least restrictive means to achieve these aims, balancing investor protection measures (ombudsman, disclosures, protection fund) balance innovation and consumer welfare. Thus, the proposed framework satisfies proportionality, aligning with constitutional jurisprudence.

Article 21, as expansively interpreted, guarantees the right to life and personal liberty, including the right to dignity and economic security.[135] Excessive regulatory uncertainty or absence of investor safeguards exposes retail participants to exploitation and fraud, undermining these rights. A statutory consumer protection framework for VDAs operationalizes Article 21 obligations by ensuring that economic participation in digital asset markets is consistent with dignity, fairness, and informational self-determination.

Directive Principles of State Policy ('DPSPs') emphasize the State's obligation to promote economic justice and equitable distribution of resources. [136] An enabling VDA regime fosters financial inclusion and technological innovation while preventing concentration of risks in opaque, unregulated markets. This aligns with the constitutional vision of inclusive economic growth.

Public policy demands balancing two competing imperatives, Investor Protection as retail investors face asymmetric risks in volatile VDA markets. Without statutory recourse, collapses such as FTX (2022) could devastate Indian households and innovation and economic Growth where overregulation or prohibition risks will stifle India's burgeoning Web3 and fintech ecosystem, driving capital and talent offshore. A calibrated framework with mandatory licensing, prudential safeguards, stablecoin oversight, rational taxation strikes this balance by mitigating risks without extinguishing innovation.

The RBI has consistently expressed concerns over stablecoins undermining monetary sovereignty.[137] Public policy must safeguard the rupee's primacy in domestic payments while allowing controlled innovation. By subjecting INR-linked stablecoins to RBI oversight and restricting foreign-currency stablecoins, the proposed framework reconciles innovation with sovereignty.

India, as G20 President in 2023, endorsed the IMF-FSB synthesis paper on crypto asset regulation, committing to implement global standards.[138] As a FATF member, India must also enforce AML/CFT measures for VASPs. A dedicated statute demonstrates India's compliance with international obligations, enhancing credibility in global standard-setting and avoiding risks of "grey-listing" for AML deficiencies. The Supreme Court has repeatedly cautioned against arbitrariness in economic reg-

135 Francis Coralie Mullin v. Administrator, Union Territory of Delhi (1981) 1 SCC 608.

136 Constitution of India, arts 38, 39.

137 RBI, Financial Stability Report (June 2022) 46.

138 IMF–FSB, Synthesis Paper: Policies for Crypto-Assets (September 2023).

ulation.[139] A coherent, statutory framework avoids ad hoc executive actions, ensuring predictability, transparency, and legal certainty—hallmarks of the rule of law.

V. CONCLUSION

This paper operates with the goal of promoting the regulation of VDAs. To do so, it first summarized the current position of regulation and their implication in India through the judgement of IAMAI v RBI. The positions of regulation by the legislature, should, in the author's opinion, be subject to change. This would bring India to par with other jurisdictions experienced in matters of regulation of VDAs. This change is necessary as the regulation of VDAs will offer India the much-needed solution to the challenges it is currently facing to balance its conservative regulatory tradition and burgeoning digital economy. This recommendation has been made while considering the growing nature of virtual digital assets. If Indian legislators were to allow the regulation of VDAs as proposed, the author believes that there is much to learn and borrow from these other, more experienced jurisdictions. However, any legislative model allowing the regulation of VDAs should explicitly recognize the same, specifically state the types of trust disputes that could be arbitrated, and comment on the enforceability of arbitration clauses in trust deeds. Furthermore, a statutory mechanism should also exist to preserve monetary sovereignty while accommodating private innovation. A legislative change to this effect could also go a long way in ensuring that India's growing image as a potential market of VDAs continues to strengthen.

139 Shayara Bano v. Union of India (2017) 9 SCC 1.

THE CRYPTO CONUNDRUM: THE CASE FOR A SUBSTANCE-BASED FRAMEWORK IN CLASSIFYING CRYPTOASSETS

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ABSTRACT

Crypto assets have emerged as important instruments in the global digital economy, and India is now among the largest markets for their use and trade. Their rapid adoption has demonstrated significant potential for innovation in finance and investment. At the same time, the absence of a clear regulatory framework has left users exposed to risks such as fraud, exchange collapses, volatility, and illicit transactions, while taxation under the Income Tax Act, 1961 remains the only formal recognition. This limited approach fails to provide safeguards necessary for investor protection or financial stability.

This paper examines the regulatory challenges presented by crypto assets and proposes a structured framework for their governance in India. It adopts a functional and comparative analysis, drawing on international standards and domestic legal principles, to argue that regulation must be grounded in both the technological form and the substantive value or rights represented by these assets.

This paper finds that crypto assets cannot be treated as a uniform class. A distinction is required between digitally native assets, such as security tokens, stablecoins, and fractional ownership models, and digital twins like tokenised securities. Regulating tokens alone is inadequate; enforceability standards for smart contracts and rules addressing centralisation and decentralisation are essential. The paper recommends a layered framework combining broad, technologically agnostic definitions with targeted amendments to securities, property, and financial laws, supported by IT and security standards for distributed ledger infrastructure. This enhances investor protection, mitigates systemic and technological risks, and creates conditions for sustainable innovation in digital finance.

INTRODUCTION

Cryptocurrencies have become one of the most significant developments in the digital economy. They are widely traded across global markets and are increasingly being used as instruments of investment or accessing goods or services. India today stands among the largest cryptocurrency markets in the world, and industry projections suggest that revenues may reach nearly USD 9.7 billion by 2025 with an average revenue per user of USD 81.2.[140] Such figures reflect the pace of adoption and the scale at which this sector is growing within the Indian financial landscape.

Despite this rapid expansion, there is still no clear regulatory framework in India to govern the operation and use of crypto assets ('CA'). The only formal recognition comes through taxation. Section 2(47A) of the Income Tax Act, 1961 ('Income Tax Act') defines the term "virtual digital asset" ('VDA') and brings it within the scope of

140 Statista, *Cryptocurrencies – India: Market Report* (2025), https://www.statista.com/outlook/fmo/digital-assets/cryptocurrencies/india (last visited Sept. 20, 2025).

taxation.[141] However, the scope of the Income Tax Act is mainly limited to revenue collection and fostering economic growth. It does not provide the safeguards of a regulatory regime. The mere fact that crypto transactions are taxed does not address the risks that arise from their use or the systemic implications they may create.

The absence of regulation has already exposed investors to significant risks. Indian investors have faced losses through exchange collapses, fraudulent token offerings, and market manipulation. The collapse of platforms such as Vauld in 2022 left thousands of retail investors unable to withdraw their savings,[142] while scams such as the GainBitcoin fraud have shown how unregulated operators can exploit the lack of oversight.[143]

The risks are not limited to individual investors. The extreme volatility of cryptocurrencies also poses potential threats to financial stability. Price fluctuations in major tokens have repeatedly demonstrated how quickly valuations can collapse. If left unregulated, such volatility can spill over into the wider financial system once exposure grows.[144] Additionally, the cross-border and decentralised nature of these assets make them particularly vulnerable to money laundering, illicit financing, and other unlawful activities.

It is evident that CAs are not uniform in nature. They include stablecoins, tokenised securities, security tokens, and non-fungible tokens ('NFT'), each with distinct features and risks. For this reason, a single regulatory approach is neither possible nor desirable. What is needed is a classification-based framework that recognises these differences and provides tailored oversight. Such a framework is essential not only to protect investors but also to safeguard the stability of the financial system and to create an environment where innovation in digital finance can develop within the bounds of law.

II. POLICY FOR REGULATION OF CRYPTOASSETS

A. SCOPE OF REGULATION-DEFINING CA

The starting point in framing a regulatory framework for CAs lies in how they are

141 Income-tax Act, No. 43 of 1961, §§ 2(47), 115BBH, 194S.

142 Pawan Nahar, *A Look at What Went Wrong With Vauld*, *Economic Times* (July 7, 2022), https://economictimes.indiatimes.com/markets/cryptocurrency/where-did-vauld-go-wrong-and-what-led-it-to-the-verge-of-end-game/articleshow/92728479.cms (last visited Sept. 14, 2025).

143 *GainBitcoin Scam: CBI Conducts Searches at 60 Locations Across India*, *The Hindu* (Feb. 25, 2025), https://www.thehindu.com/news/national/gainbitcoin-scam-cbi-conducts-searches-at-60-locations-across-india/article69262605.ece (last visited Sept. 14, 2025).

144 Fan Zhou, *Cryptocurrency: A New Player or a New Crisis in Financial Markets? — Evolutionary Analysis of Association and Risk Spillover Based on Network Science*, *Physica A: Statistical Mechanics and its Applications* 648 (2024): 129955, https://www.sciencedirect.com/science/article/pii/S0378437124004643 (last visited Sept. 20, 2025).

defined and classified. The Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 ('the Bill'), marked India's first attempt to define cryptocurrency as, "by whatever name called, means any information or code or number or token not being part of any Official Digital Currency, generated through cryptographic means or otherwise, providing a digital representation of value which is exchanged with or without consideration, with the promise or representation of having inherent value in any business activity which may involve risk of loss or an expectation of profits or income, or functions as a store of value or a unit of account and includes its use in any financial transaction or investment, but not limited to, investment schemes." The definition, however, focused narrowly on tokens as investment or profit-oriented instruments.[145] This left out other categories such as utility tokens, governance tokens, or NFTs that may not involve financial gain. The Bill restricted flexibility and left no room for capturing a broader spectrum of CAs.

However, CAs do not represent a single homogeneous category. They may be generally understood as digital tokens or representations created, stored, or transferred using distributed ledger technology ('DLT'), which can be designed to signify or embody a wide range of values, rights, or interests. In line with emerging internal and international standards, an ideal definition of CAs is intended to capture the form and basic technological function of CAs, while recognizing that their regulatory treatment must also be informed by their substantive characteristics. As a consequence of this diversity, a single 'one size fits all' classification is neither practical nor effective. Regulatory oversight, therefore, cannot rest solely on the outward form or technological structure of a token and must also take into account the substance of the rights, obligations, or values it represents.

International standards also reflect a similar approach by framing broad and technologically agnostic definitions of CAs. The Taxonomy of Legal Issues Related to the Digital Economy prepared by the Secretariat of the United Nations Commission on International Trade Law describes them thus: "virtual assets (crypto assets) refer to any digital representation of value that can be digitally traded, transferred or used for payment."[146] Likewise, the Financial Action Task Force ('FATF') defines a "virtual asset" as "a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations."[147]

These definitions are intentionally wide in scope. They capture the essential functional elements which are digital representation, reliance on DLT, and ability to

145 Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019, § 2(1)(a) (India).

146 United Nations Commission on International Trade Law, *Taxonomy of Legal Issues Related to the Digital Economy*, ¶ 82 (2023), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/digitaleconomytaxonomy.pdf (last visited Sept. 20, 2025).

147 Financial Action Task Force, *Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers*, ¶ 33(b) (2019), https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/RBA-VA-VASPs.pdf (last visited Sept. 20, 2025).

store or transfer value, while leaving room for further classification.

B. TYPES OF CRYPTO ASSETS: PRIMARY CLASSIFICATION

Before commenting on whether CAs necessitate the creation of an entirely new set of classifications under the broader umbrella of law, the scope of existing legal and regulatory frameworks must first be examined and the extent to which they already apply to CAs in their present forms assessed. This exercise requires mapping the characteristics of different types of CAs against current statutory and regulatory provisions in areas such as securities law, payments regulation, property rights, and contract law. Only then can policymakers identify whether CAs can be effectively governed within the contours of existing legislation or whether gaps exist that leave certain classes of CAs outside regulatory reach. Where such gaps are found, it then becomes necessary to consider targeted regulatory intervention to ensure efficient and proper oversight without stifling innovation. Specifically, classification of CAs should not be approached in the abstract but should flow from a systematic analysis of how well current laws capture their substance and where new frameworks may be justified.

The CAs shall be primarily categorized in the following two classes on the basis of their existence i.e., (i) digitally native and (ii) digital twin. Digitally native assets are those that originate and exist solely in digital form, without any physical counterpart. They represent the primary record of value on the distributed ledger and do not require reconciliation with another system of record. Contrastingly, digital twin assets are digital representations of pre-existing real-world assets, serving as a secondary record of value that corresponds to and requires validation or reconciliation with an off-chain system of record. This distinction is a requisite for regulatory purposes, as it allows oversight to account for both the technological form of a token and also the substantive rights or values it represents.

The second category, referred to as digital twins, covers cases where CAs mirror existing physical or legal assets. In such instances, the tokenisation process does not create a new asset class but rather provides a digital counterpart to conventional records or registers. A digital twin may be understood as an electronic controllable record representing an asset that has been immobilized on another system of record and reconciled with that original system of record to ensure ownership is reflected precisely. Examples include tokenised securities, tokenised land records, or warehouse receipts, all of which already exist within established legal and regulatory frameworks. Accordingly, no substantive new regulation is required beyond the formulation of technical standards to ensure that DLT-based systems are secure, interoperable, and enforceable. This distinction between digitally native assets and digital twins is vital for India to establish a regulatory framework that fosters genuine innovation while avoiding unnecessary duplication of oversight for mere technological upgrades

Below is Figure. 1, which shows the classification that the Indian framework

should develop as an example, to avoid overlap while still maintaining clarity.

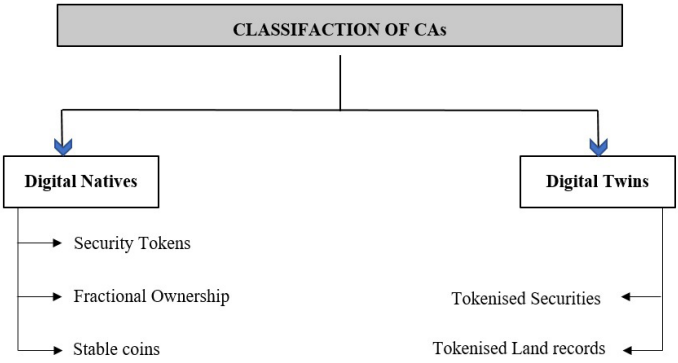

Fig. 1. Classification of CAs based on substance

C. REGULATING CAS WHICH ARE DIGITAL TWINS

Firstly, the digital twins since they are easier to understand compared to the other category. A digital twin does not create anything new but mirrors an existing real-world asset in digital form. It is essentially a process of tokenisation, where a distributed ledger acts as a wrapper around the asset, carrying it into the digital space without altering its underlying nature.[148]

This can apply to property rights, land titles, securities, or even physical goods, where the token acts as a faithful representation of ownership or entitlement. In essence, tokenisation allows the traditional asset to be carried into the digital space without altering its underlying nature.

1. TOKENIZED SECURITY

A tokenised security essentially refers to a digital twin of an existing security or financial instrument. It does not create a new asset class in itself but rather represents an already issued instrument on a distributed ledger.[149] For instance,

148 CFTC Global Markets Advisory Committee, Digital Assets Classification Approach and Taxonomy: Recommendations to the Commodity Futures Trading Commission by the Digital Asset Markets Subcommittee, ¶ 6(a) (Mar. 6, 2024), https://www.cftc.gov/media/10321/CFTC_GMAC_DAM_Classification_Approach_and_Taxonomy_for_Digital_Assets_030624/download (last visited Sept. 20, 2025).

149 Asia Securities Industry & Financial Markets Association (ASIFMA), *Tokenised Securities: A Roadmap for Market Participants and Regulators* (Nov. 2019), https://www.asifma.org/wp-content/uploads/2019/11/tokenised-securities-a-roadmap-for-market-participants-final.pdf (last visited Sept. 20, 2025).

shares, bonds, or debentures recorded in the traditional register can be mirrored on a blockchain in the form of tokens.[150] These tokens satisfy the definition of securities under Indian law because their underlying asset already falls within the ambit of securities legislation. The tokenisation process merely provides a digital wrapper, allowing the same security to be transacted through a technologically advanced medium. Further, dematerialised securities that are issued through DLT or similar technology will also be considered under this.[151]

This means tokenised securities do not demand a wholly new legal regime. They continue to be securities and should therefore be regulated as such. In the Indian context, the Securities Contracts (Regulation) Act, 1956 ('SCRA') along with Securities and Exchange Board of India's ('SEBI') regulations already provide a comprehensive framework.[152] Rather than designing an entirely new law, a simple amendment to include tokenised securities within the scope of existing provisions would suffice.

This could take the form of an "infrastructure risk add-on" to address vulnerabilities unique to distributed ledger systems, such as cyberattacks, code failures, or flaws in smart contracts.[153]

From the standpoint of regulation, tokenising securities is not a major challenge. The substantive law governing issuance, trading, and settlement already exists. What is required is an enabling framework that lays down the process of tokenisation. This would involve standards for technological infrastructure, periodic audits of smart contracts, custody and safekeeping arrangements for the digital tokens, and robust risk management protocols. Once these safeguards are in place, the existing body of securities law can continue to regulate all other aspects of trading and compliance.[154]

What India needs is not a brand-new law but targeted amendments to ensure clarity and smooth integration of this technology into existing capital market structures. If implemented carefully, tokenisation could make Indian securities markets faster, more transparent, and more inclusive, without undermining investor protection or market stability.

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150 Supervisory Policy Manual CRP-1: Classification of Cryptoassets, § 2.2.2 (Hong Kong Monetary Authority, 2025).

151 Supervisory Policy Manual CRP-1: Classification of Cryptoassets, § 1.2.2 (Hong Kong Monetary Authority, 2025).

152 Securities Contracts (Regulation) Act, No. 42 of 1956, § 2(h) (India).

153 Supervisory Policy Manual CRP-1: Classification of Cryptoassets, § 2.2.2 (Hong Kong Monetary Authority, 2025).

154 Government of Telangana, *Technical Guidance Note on Asset Tokenization*, ¶ 8 (Dec. 2023), https://it.telangana.gov.in/wp-content/uploads/2023/12/Technical-Guidance-Note-on-Asset-Tokenization.pdf (last visited Sept. 20, 2025).

2. TOKENISED LAND RECORDS

Tokenised land records fall within the category of digital twins, as they merely place existing ownership data onto a distributed ledger. This form of tokenisation does not create a new asset but provides a digital mirror of the original record, ensuring authenticity and transparency. Importantly, such tokenisation is restricted to single ownership cases; once multiple ownership layers or fractionalisation are introduced, the asset no longer remains a twin but turns into a digitally native construct. The key benefits include faster verification, easier accessibility, and the use of smart contracts to automate transactions, thereby reducing bureaucratic delays, cutting down on paperwork, and lowering the scope for tampering. It also ensures that records are available in real-time to all relevant stakeholders, thereby improving efficiency and trust in property dealings.[155]

Applying the same ideas as security tokens, these need not be regulated as it would create an overlap. The important thing to take note of would be the security concern which arises out of the technological aspect for which there needs to be the same regulation applied as that to native tokens which emerge from DLT.

D. REGULATING CRYPTOASSETS WHICH ARE DIGITAL NATIVES

Digital native CAs differ from digital twins in that they do not simply mirror an existing asset but originate entirely on distributed ledgers.

1. SECURITY TOKENS

Security tokens are CAs that, in substance, confer rights or claims equivalent to those of traditional securities under law, but are issued natively on or designed for DLT rather than simply tokenising an already existing security.[156] They may grant ownership, entitlement to dividends, profit sharing, or voting rights. Security tokens differ from tokenised securities in that they are not simply a digital wrap over a conventional security; rather, their origin, transfer, or structure is inherently linked to DLT, often with novel features or rights that do not map exactly onto traditional securities forms.[157]

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155 *Tokenization of Land Registry over Blockchain: Revolutionizing Real Estate Transactions*, RWaltz Blog (Nov. 2019), https://www.rwaltz.com/blog/tokenization-of-land-registry-over-blockchain-revolutionizing-real-estate-transactions (last visited Sept. 22, 2025).

156 CFTC Global Markets Advisory Committee, Digital Assets Classification Approach and Taxonomy: Recommendations to the Commodity Futures Trading Commission by the Digital Asset Markets Subcommittee, ¶ 6(b) (Mar. 6, 2024), https://www.cftc.gov/media/10321/CFTC_GMAC_DAM_Classification_Approach_and_Taxonomy_for_Digital_Assets_030624/download (last visited Sept. 20, 2025).

157 Circular on Intermediaries Engaging in Tokenised Securities-Related Activities, Rule 6, SFC Circular Ref. No. 23EC52 (Nov. 2, 2023), § 6, https://apps.sfc.hk/edistributionWeb/api/circular/list-content/circular/doc?refNo=23EC52&lang=EN (last visited Sept. 20, 2025).

It is important to note that, tokenised securities fall within the subset of existing regulated securities, whereas security tokens are a new subset of crypto-assets that replicate securities in form and function but originate on blockchain.[158]

The guiding principle here is "same activity, same risks, same regulation." If the risk profile of the instrument remains unchanged, then the regulatory obligations such as capital requirements, liquidity norms, and disclosure duties should equally apply to tokenised forms.[159] The only area where regulators may need to impose an additional layer of oversight is in relation to technological risks.

The advantages of security tokens are, however, significant. One of the most promising benefits is the possibility of real-time or near real-time settlement. Today, securities transactions in India generally follow a T+1 cycle, which involves a delay of one business day between trade and settlement. Tokenisation offers the prospect of T+0 settlement, effectively eliminating counterparty risk and reducing the reliance on clearing corporations. This has the potential to release capital tied up in settlement processes, thereby improving market efficiency.[160]

Another key advantage is the ability to embed regulatory compliance directly into the transaction process. Smart contracts can be designed to enforce rules automatically; for e.g., restrictions on foreign investment limits, lock-in periods, or industry-specific caps. This reduces the scope for regulatory breaches while cutting down the compliance burden on intermediaries and issuers.[161]

Fractional ownership of high-value assets is another area where security tokens could open new opportunities. Real estate, infrastructure projects, or private equity often demand large ticket investments that are out of reach for ordinary investors. By dividing such assets into smaller tradable units through tokenisation, a much broader retail investor base can participate. This not only democratises access but also deepens capital markets by increasing liquidity.[162]

Security tokens can be interoperable across different markets, providing cross-border facilities. On the condition that they comply with the Foreign Exchange Management Act, 1999 ('FEMA') and other relevant laws, issuers may find it easier to raise capital from international investors and facilitate seamless trading across jurisdictions. This could position India as a more attractive hub for global capital flows.[163]

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158 Id.

159 Supervisory Policy Manual CRP-1: Classification of Cryptoassets, § 1.3.2 (Hong Kong Monetary Authority, 2025).

160 Aditya Moudgil, *Tokenised Securities and the Future of Capital Markets: Is India Ready?*, Taxtmi (July 2025), https://www.taxtmi.com/article/detailed?id=14821 (last visited Sept. 20, 2025).

161 Warren Liang, *Smart Contracts and Corporate Governance: Automation, Legal Risks, and Benefits* (Jan. 23, 2025), available at ResearchGate, https://www.researchgate.net/publication/388288770_Smart_Contracts_and_Corporate_Governance_Automation_Legal_Risks_and_Benefits (last visited Sept. 20, 2025).

162 Anes Bukhdir, *What Is a Native Token? Understanding Its Role in Blockchain Ecosystems*, Morpher Blog (Aug. 13, 2024), https://www.morpher.com/blog/native-token (last visited Sept. 20, 2025).

163 Antonio Lanotte, *Tokenization Takes on Financial Services and Capital Markets*, at 8 (Global Blockchain Business Council, written submission to the U.S. Securities & Exchange Commission Crypto Task

Transparency is another built-in strength of distributed ledger technology. Every transaction involving a tokenised security leaves a permanent, tamper-proof record. This audit trail reduces the risk of manipulation, insider trading, or opaque practices that often erode investor confidence. Regulators, too, benefit from real-time access to transaction histories, making supervision more effective.[164]

Finally, the reduction of intermediaries is an economic advantage worth emphasising. Traditional securities markets rely heavily on brokers, registrars, and clearing corporations, each adding cost and delay to the process. With security tokens, many of these functions can be automated or streamlined, resulting in significant savings for both issuers and investors.[165]

In sum, security tokens represent a distinct evolution from tokenised securities, offering efficiencies and opportunities that traditional frameworks cannot easily replicate. By embedding compliance, enabling real-time settlement, and expanding access through fractional ownership, they hold the promise of reshaping capital markets. Yet, their novelty also demands careful oversight to address technological risks without stifling innovation. A balanced approach will ensure that security tokens complement existing securities law while unlocking their transformative potential.

2. FRACTIONAL OWNERSHIP

Fractional ownership is a model that enables multiple investors to collectively purchase and hold an expensive asset that would otherwise be out of reach for most individuals. This model can be a native or a twin depending on the nature of the underlying asset.

Instead of one person bearing the entire financial burden, funds are pooled and the asset is owned in proportion to each person's contribution. This not only makes high-value assets such as commercial real estate, private jets, or luxury yachts more accessible, but also allows investors to enjoy income generated from the asset, such as rental returns from a property, while proportionately sharing associated costs and liabilities.[166]

When this structure is replicated through tokens, the arrangement essentially becomes digitised and tradable. Tokens that represent fractional ownership in such assets, but do not transfer full legal title or real ownership, are more akin to securities or units in a collective investment scheme. As a result, these native security tokens require regulation under securities law to ensure investor protection and

Force, May 14, 2025), https://www.sec.gov/files/ctf-written-antonio-lanotte-global-blockchain-business-council-051425.pdf (last visited Sept. 20, 2025)

164 Umair Tanveer, Shamaila Ishaq & Thinh Gia Hoang, *Tokenized Assets in a Decentralized Economy: Balancing Efficiency, Value, and Risks*, *Int'l J. Production Econ.* 282 (2025), art. no. 109554, https://www.sciencedirect.com/science/article/pii/S0925527325000398 (last visited Sept. 20, 2025).

165 Aditya Moudgil, *Tokenised Securities and the Future of Capital Markets: Is India Ready?*, Taxtmi (July 2025), https://www.taxtmi.com/article/detailed?id=14821 (last visited Sept. 20, 2025).

166 Bhuvan Rustagi, *How Fractional Ownership Makes High-Value Real Estate Accessible to Everyone*, Lendbox Blog (Jan. 13, 2025), https://www.lendbox.in/blogs/how-fractional-ownership-makes-high-value-real-estate-accessible-to-everyone (last visited Sept. 23, 2025).

compliance with financial norms. This is important because while the technology may make fractional ownership easier and more liquid, the underlying risk and regulatory character remain aligned with traditional securities markets.

3. STABLE COINS

Stablecoins represent an important category of CAs where the key objective is to reduce the inherent volatility of digital tokens by pegging their value to an external reference.[167] This pegging mechanism acts as a stabilisation tool, ensuring that the token does not fluctuate as wildly as other cryptocurrencies like Bitcoin or Ether. Among these, fiat-backed stablecoins are the most prominent. Since fiat currencies such as the US Dollar or Indian Rupee are relatively stable and regulated directly by central banks, tokens pegged to them generally pose fewer risks. They function primarily as a medium of exchange or means of payment, mirroring the value of the underlying fiat without introducing significant credit, liquidity, or market risks.

On the other hand, not all stablecoins are pegged to fiat. Some are backed by commodities, real assets, or even a diversified basket of goods and rights. For example, a stablecoin may derive its value from a reserve of gold, oil, or other tangible assets. These tokens attempt to maintain stability by collateralising the underlying asset in amounts equal to the outstanding value of coins. However, such structures expose investors to risks linked to liquidity, maturity transformation, and valuation uncertainties, since the price of the reference asset itself can fluctuate significantly. Hence, while both fiat-backed and asset-backed stablecoins use similar methods of collateralisation, their regulatory treatment must differ, recognising the additional risks associated with non-fiat reference models.[168]

For example, USD Coin ('USDC'), a fiat-backed stablecoin pegged one-to-one with the US Dollar, which is widely accepted as a payment token. By contrast, Digix Gold Token ('DGX'), backed by physical gold reserves, is an example of a commodity-referenced stablecoin. While both provide a hedge against volatility, the regulatory considerations for DGX must extend to market and commodity risks, unlike USDC which is tethered to the more predictable fiat currency framework.

It is also essential to clarify that a central bank digital currency ('CBDC'), would not be classified as a stablecoin in the digitally native category. Instead, it is best understood as a digital twin of fiat currency. This is because CBDCs are not independent tokens pegged for stabilisation purposes but are themselves the digital form of legal tender, backed entirely by the sovereign authority of the state. In other words, while stablecoins mimic stability through pegging, a CBDC represents the fiat currency itself in digital form, and thus belongs to the digital twin category

167 Financial Stability Board: 'Regulatory issues of stablecoins' 18 October 2019 (https://www.fsb.org/wp-content/uploads/P181019.pdf).

168 Asia Securities Industry & Financial Markets Association (ASIFMA), *Tokenised Securities: A Roadmap for Market Participants and Regulators*, at 7 (Nov. 2019), https://www.asifma.org/wp-content/uploads/2019/11/tokenised-securities-a-roadmap-for-market-participants-final.pdf (last visited Sept. 20, 2025).

rather than being a digitally native asset like stablecoins.

E. REGULATIONS REGARDING NFTS AND UTILITY TOKEN

1. NON-FUNGIBLE TOKENS

As far as NFTS are concerned, it constitutes a CA that is inherently non-fungible in nature, meaning that no identical or interchangeable copy of such a token can be produced. This characteristic is essentially a technological feature, rather than a categorical legal distinction, and accordingly, NFTs cannot and should not be treated as a distinct class of CA in themselves. Instead, NFTs are better understood as a technological form that may be leveraged across a range of products and asset types, each with its own substantive characteristics.

The principle of non-fungibility manifests across multiple dimensions, including but not limited to: exclusivity of ownership, assertion of copyright and intellectual property rights, and authentication of provenance. Any crypto-product which requires non-duplicity or uniqueness as an essential feature will, in practice, necessitate the use of NFTs. Such NFTs may be digitally native (originating exclusively on-chain) or serve as digital twins (mirroring existing off-chain assets).

Therefore, as already classified, the mere fact that a CA takes the form of an NFT does not, in itself, create a separate regulatory category. Its regulatory treatment must depend on the substance of the value and features it inheres, and where two products share the same substantive features, they should be subject to the same regulatory approach, irrespective of whether or not they are structured as NFTs.

2. UTILITY TOKENS

As far as utility tokens are concerned, these represent CAs which primarily offer services or access to features within a closed-loop ecosystem. By their very design, they cannot be used or redeemed outside of the ecosystem that has issued them.[169]

If a technologically neutral approach is applied, utility tokens are functionally analogous to closed-loop instruments or in-house digital products, and therefore do not constitute a separate class of CA in themselves. Under applicable Indian laws, such tokens are likely to be not regulated applying same utility and same regulation approach, since the Reserve Bank of India ('RBI') regulates only those prepaid payment instruments ('PPIs') that can either (i) be converted into equivalent cash, or (ii) be used across multiple ecosystems.[170] Pure closed-loop products, which can only be re-

169 Emily Ekshian, *Explainer: Utility vs. Security Tokens*, Crypto for Innovation (Aug. 22, 2024), https://cryptoforinnovation.org/utility-tokens-security-tokens-blockchain-digital-assets-tokens-ownership-regulations-crypto-defi/ (last visited Sept. 20, 2025).

170 Reserve Bank of India, *Master Directions on Prepaid Payment Instruments (PPIs)*, MD-PPI (Aug. 27, 2021, amended Feb. 23, 2024) (India), https://www.rbi.org.in/scripts/bs_viewmasdirections.aspx?id=12156

deemed within the issuing ecosystem, fall outside this regulatory scope.

Comparative regulatory practice in other jurisdictions also reflects a similar position. In-house or closed-loop reward systems, which are redeemable exclusively within the network or ecosystem that issues them, are generally exempted from financial regulation, as their risks are limited to the boundaries of the ecosystem and do not create broader systemic implications.

Therefore, where such tokens operate purely within a closed ecosystem and do not have cash-convertibility or cross-ecosystem functionality, they should be regarded as outside the scope of financial regulation, consistent with both Indian law and international practice

III. INTERNATIONAL STANDARDS FOR DEFINITION OF CRYPTOASSETS

Regulation of CAs grows increasingly necessary, as the volume and types of transactions involving such structures increases with time. Some jurisdictions, like Hong Kong and Switzerland, already have integrated classification frameworks according to their demographic and regulatory needs. Legislative definitions across a few jurisdictions are enumerated in Table 1 as follows.

Table 1: Definitions of 'cryptoasset' (and analogous terms) in EU, Hong Kong, Switzerland, UAE and UK.

Jurisdiction	Definition
European Union (EU)	'Crypto asset' means a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology or similar technology.[171]
Hong Kong	The term 'crypto asset' refers to an asset that: is a digital representation of value; depends primarily on cryptography and DLT or similar technologies; and can be used for payment or investment purposes or to access goods or services.[172]
Switzerland	The revised Federal Ordinance on Banks and Savings Institutions ("FBO") defines the term crypto-based assets (*kryptobasierte Vermögenswerte*) as assets that, pursuant to the intention of the originator or issuer, were issued with the primary intention to substantially serve as (i) a payment instrument for the acquisition of commodities or services, or (ii) an instrument for money or value transfers.[173]

(last visited Sept. 20, 2025).

171 Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023, art. 3(5).

172 Supervisory Policy Manual CRP-1: Classification of Cryptoassets, § 1.2.1 (Hong Kong Monetary Authority, 2025).

173 Art 16 of The Swiss Federal Act on Banks and Savings Banks, https://assets.kpmg.com/content/dam/kpmgsites/ch/pdf/ch-banking-act-en.pdf

Jurisdiction	Definition
United Arab Emirates (UAE)	The Dubai Financial Services Authority's ('DFSA') defines a crypto token as a token used as a medium of exchange or for payment or investment purposes, excluding investment tokens or other types of investments.[174] The Financial Services Regulatory Authority ('FSRA') defines a crypto asset as a digital representation of value functioning as a medium of exchange, unit of account, or store of value but does not have legal tender status.[175]
United Kingdom (UK)	A 'crypto asset' is defined as a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored, or traded electronically.[176]

IV. EFFECTUATION: WHY TOKEN REGULATION ALONE IS INSUFFICIENT: SMART CONTRACTS & THE CENTRALISATION DEBATE

Token regulation is a necessary but insufficient step in establishing a coherent legal framework for CAs. The real functionality of tokens depends on the smart contracts that automate their execution. Smart contracts, which comprise code deployed on a distributed ledger that triggers specific outcomes upon defined events, can create enforceable obligations, but they also introduce risks: coding errors, reliance on external data (oracles), and uncertainty in legal interpretation or remedies.[177] Notably, while existing legal frameworks can accommodate smart legal contracts, wholly-coded agreements raise unresolved issues regarding interpretation, enforceability, and remedies.[178]

Regulation must also account for decentralisation. As Hinman argued, when a digital asset is sold into a network where purchasers do not reasonably expect a central party to manage or profit from the enterprise, the digital asset itself may not constitute a security. The degree of decentralisation influences whether participants can reasonably anticipate managerial efforts by an identifiable party, and hence the applicability of securities law. In fully decentralised systems, responsibility is dispersed, and accountability becomes challenging to establish, complicating

174 Dubai Financial Services Authority's (DFSA) Consultation Paper No. 143, para 18, https://dfsaen.thomsonreuters.com/sites/default/files/net_file_store/CP143_Regulation_of_Crypto_Tokens.pdf

175 Para 4.1, https://en.adgm.thomsonreuters.com/sites/default/files/net_file_store/Guidance_ICOs_and_Crypto_Assets_13052019.pdf

176 https://www.gov.uk/government/publications/economic-crime-and-corporate-transparency-act-2023-factsheets/economic-crime-and-corporate-transparency-act-cryptoassets-key-terms-and-definitions#contents

177 N. Ballaji, *Smart Contracts: Legal Implications in the Age of Automation*, 15 Beijing L. Rev. 1015, 1015–32 (2024), https://doi.org/10.4236/blr.2024.153061.

178 https://webarchive.nationalarchives.gov.uk/ukgwa/20250109110910mp_/https://cloud-platform-e218f50a4812967ba1215eaecede923f.s3.amazonaws.com/uploads/sites/30/2021/11/6.7776_LC_Smart_Legal_Contracts_2021_Final.pdf

enforcement and investor protection.[179]

Centralised platforms, by contrast, allow regulators to identify responsible actors and impose obligations on them, mitigating some of these risks. Therefore, an effective regulatory approach must pair crypto-asset recognition with standards for smart contract enforceability including trigger events, auditability, and fallback mechanisms. It must also consider the governance and liability implications arising from centralised versus decentralised architectures. Without addressing the operational logic and legal enforceability of smart contracts, token regulation alone leaves critical gaps.[180]

V. CURRENT REGULATORY FRAMEWORK

The RBI has consistently cautioned users, holders and traders about the risks of virtual currencies. In April 2018, it issued a circular that, while stopping short of banning such assets, effectively sought to choke their operations by directing regulated entities not to deal in virtual currencies or provide related services.[181] The circular was later challenged before the Supreme Court by the Internet and Mobile Association of India and several crypto exchanges, which argued that it violated their fundamental right to trade and do business. The Court struck it down as unconstitutional, but despite this ruling, the broader regulatory treatment of CAs in India remains unsettled, with continuing uncertainty over whether they are to be regarded as commodities, securities, derivatives or currencies.

However, SEBI has also begun experimenting with the use of DLT within the securities market. On 13 August 2021, it issued a circular which called upon depositories to develop a platform for a Securities and Covenant Monitoring System, thereby laying the foundation for DLT integration, though enforcement remains pending. More recently, the Financial Intelligence Unit ('FIU') has recognised VDAs from their 2023 circular, SEBI has moved to expand the scope of the optional T+0 rolling settlement cycle in the equity cash market, building on the beta version introduced in March 2024. From 31 January 2025, the cycle will cover the top 500 scrips by market capitalisation, beginning with the bottom 100 companies and expanding gradually.[182]

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179 William Hinman, Dir., Div. of Corp. Fin., SEC, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at Yahoo Finance All Markets Summit: Crypto (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418 (last visited Sept. 21, 2025).

180 Mienert, Biyan, Managing Cross-Border DeFi DAOs in the EU: Legal Complexities and Regulatory Perspectives (Ensuring Sufficient Decentralization under MiCA) (April 30, 2024). Available at SSRN: https://ssrn.com/abstract=4852000 or http://dx.doi.org/10.2139/ssrn.4852000

181 Internet and Mobile Association of India v. Reserve Bank of India, 2020 SCC OnLine SC 275.

182 Securities & Exchange Board of India, Circular No. SEBI/HO/MRD/MRD-PoD-3/P/CIR/2024/20 (Mar. 21, 2024) (India), https://www.sebi.gov.in/legal/circulars/mar-2024/circular-on-_xxxx_.html (last visited Sept. 20, 2025).

Parallelly, in the context of GIFT City, the International Financial Services Centres Authority ('IFSCA') has issued a consultation paper on the regulatory approach towards tokenisation of real-world assets. For this purpose, tokenisation has been described as the use of technologies such as DLT to issue or represent assets in digital form through tokens.[183] However, this approach is currently confined to GIFT City's regulatory sandbox. Moreover, while the definition appears technologically neutral, there is still considerable room for classification based on substance, particularly in determining whether tokenised instruments should be treated as securities, commodities, or another asset class altogether.

At present, India's framework around crypto-assets and DLT is largely confined to taxation and compliance, without addressing the core technological risks. Distributed ledger systems inherently carry vulnerabilities relating to cybersecurity, operational resilience, and data integrity. Unless specific IT and security standards are put in place, the system remains exposed to breaches and systemic risks. A dedicated framework on DLT infrastructure, therefore, is essential to complement financial regulation with robust technological safeguards.

VI. CONCLUSION

India's approach to CAs and tokenisation has been slow and uneven. The absence of a proper framework leaves investors unsure of their rights, creates space for misuse, and holds back innovation. One of the biggest hurdles is the lack of classification, whether these assets should be treated as securities, commodities, or currencies remains unresolved. Without clarity, compliance becomes difficult and enforcement patchy. At the same time, distributed ledger systems bring their own risks around security and oversight which current tax-based rules do not address.

However, a clear, classification-driven framework such as the one suggested, which does not make classification based on exhaustive category but on substance is necessary for the industry to grow and develop in the background of coherent regulation.

183 IFSCA, Consultation Paper on Regulatory Approach towards Tokenization of Real-World Assets, at 11 (Feb. 26, 2025) (India), https://ifsca.gov.in/Document/ReportandPublication/ifsca-consultation-paper-on-regulatory-approach-towards-tokenization-of-real-world-assets03032025111644.pdf (last visited Sept. 20, 2025).

CRYPTO JURISDICTION AND VASP REGISTRATION: A TWO-LAYERED PREVENTIVE POLICY FOR INDIA

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ABSTRACT

In 2019 and 2021, the Financial Action Task Force issued two reports which addressed the risks of virtual assets and virtual asset service providers and discussed the application of its forty recommendations on virtual assets & virtual asset service providers regulation. Virtual asset service providers are key actors in an economy where the demand for virtual assets and cryptocurrencies is increasing exponentially, for example, in India. However, the Financial Action Task Force's approach towards licensing/registration of virtual asset service providers (interpretive note to Recommendation 15) suffers from certain jurisdictional limitations. India has implemented certain regulations for virtual asset service providers under its anti-money laundering regime; however, the same jurisdictional limitations of the Financial Action Task Force's approach continue to exist here too. This paper proposes a two-layered preventive policy approach to tackle the jurisdictional limitation. The first layer (Geographic Nexus Rule) proposes a four-pronged test to impose a virtual asset service provider's legal obligation on persons (natural or legal) who have a geographic nexus to India. On the other hand, the second layer (Roots Before Fruits Rule) makes it mandatory for a foreign-origin virtual asset service provider or an equivalent entity who is willing to provide its services in India to have a physical presence in India. At the end, it recognises the limitations of the suggested policy and puts emphasis on the need to craft a solution which could enhance accountability in the virtual asset service provider regulatory regime in India but not at the cost of innovation in the field of blockchain technology.

I. INTRODUCTION

The history of money laundering is as old as the history of money itself.[184] The offence of money laundering is characterised by gaining money (often a huge amount) through illegal means such as drug trafficking, terrorist financing, etc.[185] As the concept of money evolved, so did the offence of money laundering, adapting in form and complexity over time. The establishment of the Financial Action Task Force ('FATF') in 1989 was one of the most significant steps in history to combat the issue of cross-border money laundering. In April 1990 it issued a report containing 40 recommendations ('Recommendations') to combat money laundering. Recommendation 15 ('R 15') of that report specifically warns about the exploitation of novel and developing technologies for the purpose of money laundering.[186]

Anonymous author Satoshi Nakamoto's 2008 paper marked the beginning of a new era of cryptocurrency.[187] Cryptocurrencies are digital currencies where the

184 Wouter H. Muller et al., Anti-Money Laundering: International Law and Practice, 3 (Wouter H. Muller et al. eds., John Wiley & Sons, 2007).

185 Dennis Cox, Handbook of Anti-Money Laundering, 6-9 (Wiley, 2014).

186 FATF 40 Recommendations, infra note 8, 17.

187 Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, SSRN (2008) available at https://

transactions are verified and records are maintained by a decentralised system called cryptography. Cryptocurrency is a form of virtual asset ('VA'); however, for the purpose of this paper, expressions such as 'VA,' 'virtual currency,' 'crypto asset' will be assumed and used as synonyms. In a crypto ecosystem, the virtual asset service providers ('VASP') play a key role in services related to VAs and to integrating them into the traditional financial system through its multifaceted role which includes facilitating transactions, ensuring security, complying with regulations etc.[188] The FATF defines a VASP as any natural or legal person who is not covered elsewhere under its Recommendations and as a business conducts at least one of the following activities or operations: (a) exchange between VAs and fiat currencies; (b) exchange between one or more forms of VAs; (c) transfer of VAs; (d) safekeeping and/or administration of Vas or instruments enabling control over VAs; and (e) participation in and provision of financial services related to an issuer's offer and/or sale of a VA.[189]

Unlike the conventional fiat currencies, it is way more difficult to track the flow of cryptocurrencies due to the use of blockchain technology as its foundation. For this reason, it can be exploited for money laundering purposes. FATF's Recommendations (specifically the interpretive note to R 15 ('INR 15')) argues for a robust VASP regulatory framework where the VASPs are required to register with a country's competent authority, which can be instrumental to claim jurisdiction in time of any mishappening (including money laundering) related to a VA. However, a close examination of the FATF's recommendation makes it clear that in many situations claiming jurisdiction can be extremely difficult for a country, especially when the VASPs do operate from a foreign jurisdiction. India's anti-money laundering regime flows directly from the FATF's recommendations; therefore, its VASP regulation, being a part of the anti-money laundering regime, suffers from the same infirmity. Thus, this policy paper proposes a new preventive approach regarding the registration/licensing of VASPs in India and makes an attempt to tackle FATF's jurisdictional question.

Part II of this paper examines the R 15 and INR 15 and identifies the jurisdictional gap in the FATF's approach towards VASP registration. Part III shifts the focus towards the evolution of crypto law and the Government of India's (including the Reserve Bank of India's ('RBI')) approach towards VAs & VASPs. Part IV constitutes the heart of this paper and proposes a two-layered preventive policy suggestion, namely (a) the Geographic Nexus Rule and (b) Roots Before Fruits Rule. Finally, Part V provides a brief overview of the key advantage and disadvantage of the proposed policy and concludes.

papers.ssrn.com/sol3/papers.cfm?abstract_id=3440802 (Last visited on September 13, 2025).

188 Tanya, *VASPs: Bridging Traditional Finance and the Digital Economy*, Trust Decision, July 23, 2024, available at https://trustdecision.com/articles/vasps-bridging-traditional-finance-digital-economy (last visited on November, 22, 2025).

189 FATF Guidance 2019, *infra* note 13, 57.

II. THE TEST OF 'PLACE OF BUSINESS': A CROSS-JURISDICTIONAL LEGAL LACUNA

The FATF is a trans-governmental network of national anti-money laundering & countering the financing of terrorism ('AML/CFT') officials whose raison d'être is to draft effective international responses (in the form of its recommendations) to combat money laundering and the financing of terrorism (India has been a member since 2010).[190] The Recommendations of the FATF have evolved over time; however, it took the shape of its present form in 2012.[191] In praesenti, FATF has 40 core recommendations[192] along with 9 special recommendations.[193]

R 15 required that jurisdictions and financial institutions should identify and assess the money laundering or terrorist financing risks which may arise out of (a) the development of new products and new business practices; and/or (b) the use of new or developing technologies for both new and pre-existing products.[194] In October 2018, the FATF updated the R 15[195] to ensure that VASPs are regulated for AML/CFT purposes and licensed or registered.[196] In June 2019, it adopted INR 15 and comprehensive guidance to clarify how the FATF requirements apply to VAs and VASPs.[197] The 2019 guidance was further updated in 2021 for clarity.[198]

INR 15, inter alia, provides certain principles to determine the jurisdictions that are responsible for the licensing/registration of the VASPs. However, VAs, , are not

190 Kenneth S. Blazejewski, *The FATF and Its Institutional Partners: Improving the Effectiveness and Accountability of Trans-governmental Networks*, Vol. 22(1), Temple Int'l & Comp L. J., 8 (2008).

191 Laurel S. Terry & José Carlos Llerena Robles, *The Relevance of FATF's Recommendations and Fourth Round of Mutual Evaluations to the Legal Profession*, Vol. 42(2), Fordham International Law Journal, 645 (2018).

192 FATF, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*, 16 February 2012, available at https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Fatf-recommendations.html (Last visited on September 14, 2025).

193 FATF, *FATF IX Special Recommendations*, October 2001, available at https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Ixspecialrecommendations.html (Last visited on September 14, 2025).

194 FATF 40 Recommendations, *supra* note 8, 17.

195 FATF, *Targeted Update on Implementation of the FATF Standards on Virtual Assets and Virtual Asset Service Providers*, June 2025, 6, available at https://www.fatf-gafi.org/en/publications/Fatfrecommendations/targeted-update-virtual-assets-vasps-2025.html (Last visited on September 14, 2025).

196 Louis de Koker et al., Financial Technology and the Law Combating Financial Crime, 162 (Doron Goldbarsht & Louis de Koker eds., Springer, Law Governance and Technology Series Volume 47, 2022).

197 FATF, *Targeted Update on Implementation of the FATF Standards on Virtual Assets and Virtual Asset Service Providers*, June 2025, 6, available at https://www.fatf-gafi.org/en/publications/Fatfrecommendations/targeted-update-virtual-assets-vasps-2025.html (Last visited on September 14, 2025); FATF, *Guidance for a Risk-Based Approach VAs and VASPs*, June 2019, available at https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Guidance-rba-virtual-assets.html (Last visited on September 14, 2025).

198 FATF, *Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers, October 2021*, available at https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Guidance-rba-virtual-assets-2021.html (Last visited on September 14, 2025).

limited to any fixed jurisdiction and may flow freely across the borders.[199] Thus, the jurisdictional principles of FATF's recommendations (i.e., in INR 15) leave gaps and vulnerabilities which engender significant challenges for jurisdictions (especially a developing jurisdiction like India).[200]

Paragraph 3 of INR 15 consists of two dimensions: firstly, VASPs are required to be registered at their origin jurisdiction, i.e., where they are created; secondly, where the VASP is a natural person, they should be required to be licensed or registered in the jurisdiction where their 'place of business' is located.[201] As per the guidance note(s) of FATF, a jurisdiction may consider various factors to determine the 'place of business' of a natural person, such as — (a) the primary location where the business is performed; (b) where the business' books and records are kept; and (c) where the natural person is physically present, located, or resident.[202] It further provides that where the natural person operates his/her business from his/her residence or the place of business cannot be identified, the primary residence of such natural person may be regarded as his/her place of business.[203] In such a situation, the place of business may also include the location of the server of the business.[204] Though, licensing/registering a VASP within their jurisdictional boundary looks like a cakewalk for countries, determining the place of business of a VASP which operates from an overseas jurisdiction can be extremely challenging.

Firstly, claiming jurisdiction and mandating licence/registration based on the offering of products/services to customers in a jurisdiction (place of performance of business) raises a glaring question of accountability, as there may not exist any natural person within the jurisdiction to be prosecuted.[205] The same question of accountability also arises out of grounds such as the primary residency of a natural person who is outside the jurisdiction and/or the location of the server of the business. Secondly, claiming jurisdiction based on the place where the business' books and records are kept is defective in an era of cloud services.[206] The mere fact that the key books and records can be held on a cloud server in the jurisdiction provides very little supervisory hold for the domestic regulator.[207] Thirdly, it is challenging to claim jurisdiction just because the person is physically present, located, or residing in the nation.[208] This is because the firm or business may be run by multiple manag-

199 *See* Pamela Cardozo et al., *On Cross-Border Crypto Flows: Measurement, Drivers, and Policy Implications* (International Monetary Fund Working Papers, Working Paper No. 261, 2024).

200 *See* William Guillermo Jiménez & A. R. Lodder, *Analysing Approaches to Internet Jurisdiction Based on a Model of Harbors and the High Seas*, Vol. 29(2–3), International Review of Law, Computers & Technology, 266 (2015).

201 FATF Guidance 2019, *supra* note 13, 55.

202 FATF Guidance 2019, *supra* note 13, ¶ 79; FATF Updated Guidance 2021, *supra* note 14, ¶ 126.

203 *Id.*

204 *Id.*

205 Koker, *supra* note 12, 165.

206 *Id.*

207 *Id.*

208 *Id.*

ers or partners, each of whom is located in a separate jurisdiction.[209]

This very legal loophole can be exploited by VASPs. For instance, Binance, the world's largest crypto exchange by volume (as of September 2025), has changed its jurisdiction a plethora of times to secure the most optimal regulatory framework for its business (such as China, Seychelles, and the Cayman Islands).[210] Another example of jurisdiction-shopping is the Bahamas-based FTX.[211] Hence, countries must take robust and preventive measures beyond the FATF's recommendation to protect the market and the consumers of their own jurisdiction from any VA fraud/mishappening.

III. EVOLUTION OF INDIA'S CRYPTO-LANDSCAPE

A. THE CRYPTO DILEMMA OF RBI (2013-17)

Since its inception, Bitcoin was a technological enigma. On October 26, 2010 its price saw a minuscule jump from $0.10 to $0.20.[212] However, within three years (as of November 2013) it crossed the threshold of $1,000.[213] Guillaume Babin-Tremblay, the executive director of the Bitcoin Embassy in Montreal, even remarked, "You can definitely say that 2013 has been the year of the bitcoin."[214] However, in the same year the RBI expressed its concerns regarding the potential risks associated with cryptocurrencies.[215] The RBI's crypto concern became more clear with the December 24, 2013 Press Release where it unambiguously warned the users, holders and traders of virtual currencies about the potential financial, operational, legal, customer protection and security related risks.[216]

In its 2015 Financial Stability Report, the RBI emphasised on the 'trust' & 'con-

209 *Id.*

210 *See* Helen Partz, *Thai SEC and Cayman Islands regulator take action on Binance*, Cointelegraph, July 2, 2021, available at https://cointelegraph.com/news/thai-sec-and-cayman-islands-regulator-take-action-on-binance (Last visited on September 14, 2025).

211 William Chao, *Crypto exchange's jurisdiction-shopping: a regulatory problem that requires a global response*, February 23, 2023, Columbia Journal of Transnational Law, available at https://www.jtl.columbia.edu/bulletin-blog/crypto-exchanges-jurisdiction-shopping-a-regulatory-problem-that-requires-a-global-response (Last visited on September 14, 2025).

212 John Edwards, *Bitcoin's Price History*, Investopedia, Last updated August 15, 2025, available at https://www.investopedia.com/articles/forex/121815/bitcoins-price-history.asp#citation-38 (Last visited on September 16, 2025).

213 *Id.*

214 Kitco News, *2013: Year Of The Bitcoin*, Forbes, December 10, 2013, available at https://www.forbes.com/sites/kitconews/2013/12/10/2013-year-of-the-bitcoin/ (Last visited on September 16, 2025).

215 Reserve Bank of India, *Financial Stability Report* (December, 2013), available at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FSRDEC301213_FL.pdf (Last visited on September 16, 2025).

216 Press Release, Reserve Bank of India, *RBI cautions users of Virtual Currencies against Risks*, December 24, 2013, available at https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/IEPR1261VC1213.PDF (Last visited on September 16, 2025).

trolling power' factors of central entities[217] in the traditional financial systems and questioned the anonymous and decentralised nature of the crypto currencies which may disrupt the very foundation of the traditional financial system.[218] The RBI's crypto anxiety continued in the next year's Financial Stability Report where it expressed risks and concerns about data security, consumer protection and even monetary policy.[219] Finally, the Press Release of 2017[220] can be considered as a last note of warning or worry before RBI took drastic steps against crypto/virtual assets in 2018. In that Press Release it unambiguously stated, "it [RBI] has not given any licence / authorisation to any entity / company to operate… with Bitcoin or any virtual currency… any user, holder, investor, trader, etc. dealing with Virtual Currencies will be doing so at their own risk."[221]

B. IMAI VS. RBI: A CONSTITUTIONAL STRUGGLE (2018-20)

In 2018, the RBI prohibited every institution which is regulated by it from providing any service to any person in relation to virtual currency.[222] It included inter alia — maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral etc.[223] In 2019, an inter-ministerial committee submitted its report on crypto regulation which proposed a draft Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 ('Draft Bill').[224] Under Sections 6 & 7 of the Draft Bill, use of crypto currency as legal tender or any other specified purposes (use it as a means for investment, or basis of credit etc.) would be illegal.[225] The RBI's action coupled with the report and the proposed

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217 *See* Donato Masciandaro, Central Banks or Single Financial Authorities? A Political Economy Approach, 3-6 (University of Lecce Economics Working Paper No. 47/25, 2004).

218 Reserve Bank of India, *Financial Stability Report,* 42 (December, 2015), available at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR6F7E7BC6C14F42E99568A80D9FF7BBA6.PDF (Last visited on September 16, 2025).

219 Reserve Bank of India, *Financial Stability Report,* 42 (December, 2016), available at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR_166BABD6ABE04B48AFB534749A1BF38882.PDF (Last visited on September 16, 2025).

220 Press Release, Reserve Bank of India, *RBI cautions users of Virtual Currencies*, February 01, 2017, available at https://www.rbi.org.in/commonman/Upload/English/PressRelease/PDFs/PR2054EN010217.PDF (Last visited on September 16, 2025).

221 *Id.*

222 Press Release, Reserve Bank of India, Prohibition on dealing in Virtual Currencies (VCs), April 6, 2018, available at https://www.rbi.org.in/commonman/Upload/English/Notification/PDFs/NT154ML060418.PDF (Last visited on September 17, 2025).

223 *Id.*

224 Department of Economic Affairs, *Report of the Committee to Propose Specific Actions to be Taken in Relation to Virtual Currencies* (February, 2019) https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20 Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf (Last visited on September 17, 2025).

225 *Id,* 67-68.

Draft Bill raised, for the first time, various constitutional questions.[226]

The RBI's stance did not sustain for long as its prohibitive circular of 2018 was challenged, inter alia, on the constitutional ground of violating Article 19(1)(g) of the Constitution of India (freedom of trade, business & occupation) in the case of Internet and Mobile Association of India v. RBI ('IAMAI v. RBI').[227] Firstly, applying the doctrine of proportionality[228] the Hon'ble Supreme Court observed that RBI did not consider the availability of alternatives before issuing the impugned circular.[229] It further observed that till this date any RBI regulated entity (e.g., national banks, co-operative banks, scheduled commercial banks) has not yet suffered any adverse effect or loss (directly or indirectly) which can be linked to virtual currencies.[230] The Hon'ble Supreme court made reference to the landmark Indian Hotel and Restaurants Association case,[231] and observed, "there must have some empirical data about the degree of harm suffered by the regulated entities," which the RBI failed to produce.[232] Subsequently, the Supreme Court recognised, "It is no doubt true that RBI has very wide powers… These powers can be exercised both in the form of preventive as well as curative measures. But the availability of power is different from the manner and extent to which it can be exercised."[233] Hence, the Court ruled that the RBI's 2018 circular was unconstitutional on the ground of proportionality.[234]

C. FROM BAN TO REGULATION (2021-PRESENT)

The IAMAI v. RBI verdict was a key turning point of India's crypto approach. Soon after IAMAI v. RBI, the Government of India introduced the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 ('New Bill').[235] The New Bill, like its former counterpart, also attempted to ban private cryptocurrencies with certain exceptions to promote the underlining blockchain technology.[236] Anyhow, this New Bill was never passed by the houses of the Parliament.[237]

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226 Jaideep Reddy, *The Case for Regulating Crypto-Assets: A Constitutional Perspective*, Vol. 15(2), Indian Journal of Law and Technology, 392-411 (2019).

227 Internet and Mobile Association of India (IMAI) v. Reserve Bank of India, AIR 2021 SC 2720 ('IMAI Case').

228 *See* Ajoy PB, *Administrative Action and the Doctrine of Proportionality in India*, Vol. 1(6), IOSR Journal of Humanities and Social Science (2012).

229 IMAI Case, *supra* note 43, ¶ 6.164.

230 *Id,* ¶ 6.172.

231 State of Maharashtra v. Indian Hotel and Restaurants Association, (2013) 8 SCC 519.

232 IMAI Case, *supra* note 43, ¶ 6.172.

233 *Id,* ¶ 6.173.

234 *Id,* ¶ 6.174.

235 Preeti Ratnoo, Navigating the Crossroads: Crypto Assets in India-Security, Currency, or an Uncharted Territory, 14 (LL.M, National Law School of India University, Bengaluru, 2024).

236 Sobhana K. Nair, *New cryptocurrency bill seeks to ban private players*, November 24, 2021, The Hindu, available at https://www.thehindu.com/news/national/new-cryptocurrency-bill-seeks-to-ban-private-players/article37649790.ece (Last visited on September 18, 2025).

237 Ratnoo, *supra* note 51, 14.

Through the Union Budget of 2022-23, the Government of India, for the first time, legally recognised crypto assets/currencies by defining them under its taxation regime.[238] Under Section 2(47A) of the Income Tax Act, 1961, 'virtual digital asset' was defined as "any information or code or number or token… generated through cryptographic means… providing a digital representation of value exchanged… with the promise or representation of having inherent value, or functions as a store of value or a unit of account… and can be transferred, stored or traded electronically."[239] The definition under Section 2(47A) was broad and liberal, and it specifically includes a 'Non-Fungible Token' and excludes any Indian or foreign currencies.[240] Along with the definition clause, the government introduced a flat thirty percent tax on income derived from the transfer of VAs,[241] and a one percent Tax Deducted at Source ('TDS') on crypto transactions.[242]

In March 2023, the Ministry of Finance, by issuing a notification, expanded the meaning of 'Reporting Entity' under the Prevention of Money Laundering Act, 2002 ('PMLA') to include VASPs.[243] The activities stipulated under the ministry's notification mirrored FATF's VASP definition.[244] By virtue of this notification, the government made it compulsory for every VASP operating within the jurisdiction of India to comply with the obligations of a reporting entity.[245] Such obligations include: (a) following the specific guidelines issued by the Financial Intelligence Unit ('FIU'); (b) registration with FIU; (c) conducting Know-Your-Customer checks; and (d) appointing a Designated Director and a Principal Officer.[246] VASPs are also obliged to file reports within 7 working days when — (a) it has any reasonable suspicion that the crypto transaction may involve proceeds of an offence; (b) the transaction appears to be made in circumstances of unusual or unjustified complexity; or (c) it has reasonable suspicion that the transaction may involve financing of activities relating to terrorism, etc.[247]

IV. A TWO-PRONGED PREVENTIVE POLICY SUGGESTION

238 *Id,* 14-15.

239 The Income Tax Act, 1961, § 2(47A),

240 *Id.*

241 The Income Tax Act, 1961, § 115BBH.

242 The Income Tax Act, 1961, § 194S.

243 Ministry of Finance (Department of Revenue), S.O. 1072(E) (Notified on March 7, 2023).

244 *Id.*

245 Athif Ahmed & Reddy Pawan Kumar, *Blockchain & Cryptocurrency Laws and Regulations 2025 – India*, October 10, 2024, Global Legal Insights, available at https://www.globallegalinsights.com/practice-areas/blockchain-cryptocurrency-laws-and-regulations/india/#_edn9 (Last visited on September 18, 2025).

246 *Id.*

247 *Id.*

From the discussion of the previous two chapters, it is quite clear that India's approach towards crypto regulation has remained sceptical. The present VASP regulation law in India closely imitates the recommendations of the FATF, yet it is not only an inadequate measure but also suffers from the same infirmity of the FATF's jurisdictional approach (see chapter II). Therefore, this chapter proposes a two layered preventive policy suggestion to strengthen regulatory grip and foster accountability in relation to the jurisdictional question of VASP registration/licensing. Having said that, this chapter does not take into account a situation where a VASP is originated in India and provides its services (mentioned under the Ministry of Finance March 7, 2023 notification) to Indian consumers, as it is already covered by the existing laws.

A. LAYER 1: 'GEOGRAPHIC NEXUS' RULE

The first layer of preventive measure vitalizes the VASP regulatory framework of India to cover those persons (legal or natural) who have a geographic nexus to India. It lays down certain situations/conditions which would create an assumption of a geographic nexus between the entity in question and India's VASP regulatory authorities, and an entity having a geographic nexus must fulfil all the obligations of a VASP as mandated by the Government of India or competent authorities in India. Those specified conditions where the geographic link would be assumed are:

> When a person (natural or legal), being a VASP and a resident of India, provides its services to people in a foreign country;
> When a person (natural or legal), being a resident of India, functions as an agent or subsidiary of an entity which would be deemed to be a VASP if it was situated in India, and provides its services to people in India or a foreign country;
> When a person (natural or legal), not being a VASP but being a resident of India, exercises significant control over the conduct of a foreign VASP or an equivalent entity which is not registered in India;
> When a business, not being in India but which would be deemed to be a VASP if it was situated in India, maintains a bank account, server, or its books & records in India.

The ethos of the first two conditions can be traced back to Section 6(6) of the Anti-Money Laundering and Counter-Terrorism Financing Act, 2006 ('AML/CFT Act') of Australia.[248] The first condition attempts to prevent the misuse of Indian soil as a host jurisdiction for any crypto-related offences beyond its territory. The following condition is just an extension of the first condition, which also includes an agent or a subsidiary of a foreign entity. For example, 'A' is a resident of India and works as an agent of 'B,' who is a crypto service provider in Country X. 'B' scams people in Country Y via 'A.' Now, as per the said condition, 'A' is required to get registered with a competent authority and fulfil the obligations of a VASP in India otherwise,

248 The Anti-Money Laundering and Counter-Terrorism Financing Act, 2006, § 6(6).

his actions would be considered illegal per se.

The key question regarding the first two conditions (including the 'condition-c') is — What would constitute a valid residency? India may adopt a test of residency like the test given under Section 14 of the AML/CFT Act. As per Section 14, "an individual is a resident of a particular country if, and only if, the individual is ordinarily resident in that country."[249] This provision also provides different criteria for a company,[250] trust,[251] partnership,[252] and corporation.[253]

The third condition is not exactly a preventive measure. It rather works like a legal instrument which can be used by the government to impose liability on a person with cross-border ties. However, the test of significant control can be legally absurd. Thus, inspiration can be taken from India's beneficial ownership regime, and factors such as the holding of shares and voting rights in a company or any other control over other legal vehicles can be prioritised for an objective assessment.

The last condition is a blend of FATF's recommendation[254] and Canada's 'real and substantial connection' test.[255] Under this condition the geographic nexus is established by the virtue of certain documents or actions. However, as discussed previously in chapter II, things like cloud service and virtual private networks can make the enforcement of this condition extremely difficult.

B. LAYER 2: 'ROOTS BEFORE FRUITS' RULE

The second layer of prevention deals with a situation where a foreign registered VASP provides its services in India without any local physical presence. The metaphorical meaning of this rule is that — an entity must have its roots (local presence) in India before providing its fruits (crypto services of any kind) to people in India.

The legislative genesis of this rule can be found in the Singaporean and Japanese law. Foreign VASPs who want to operate in Singapore are required to get a valid licence under the Payment Services Act, 2019 ('PSA').[256] As per the provisions of PSA, two key requirements to get a valid licence are: firstly, the applicant must have at least one executive director who is a Singapore citizen or permanent resident, or at least one non-executive director who is a Singapore citizen or permanent resident along with at least one executive director who possesses a Singapore employment pass; and secondly, the applicant must have a permanent place of business or a registered office in Singapore, at which it keeps books of all its transactions in re-

249 The Anti-Money Laundering and Counter-Terrorism Financing Act, 2006, § 14(1).

250 The Anti-Money Laundering and Counter-Terrorism Financing Act, 2006, § 14(2).

251 The Anti-Money Laundering and Counter-Terrorism Financing Act, 2006, § 14(3).

252 The Anti-Money Laundering and Counter-Terrorism Financing Act, 2006, § 14(4).

253 The Anti-Money Laundering and Counter-Terrorism Financing Act, 2006, § 14(5).

254 FATF Guidance 2019, *supra* note 13, ¶ 79; FATF Updated Guidance 2021, *supra* note 14, ¶ 126.

255 Koker, *supra* note 12, 171.

256 The Payment Services Act, 2019.

lation to the payment services it provides.[257] The Japanese law mandates that any foreign entity willing to get registered as a Crypto Asset Exchange Services (equivalent to VASP) must establish either a subsidiary (in the form of stock companies also known as kabushiki-kaisha) or a branch in Japan and have a local presence.[258] The compulsory local presence of a VASP, on one hand, ensures that in a future crypto mishappening, at least somebody would be held liable; on the other hand, it discourages any shady practices in the jurisdiction on behalf of a foreign entity.

V. CONCLUSION

The two-layered policy suggested in this chapter promises several key advantages. For example, being a technologically neutral policy, it does not stifle any future innovation in the arena of blockchain technology. However, on the flip side, it has some glaring disadvantages as well. The two layers of preventive measures are incapable of answering the multi-dimensional challenges of the recent uprising of decentralised finance, and compulsory local presence may hinder ease of business and create barriers for new crypto startups, as they have very limited resources.

Furthermore, incorporation of the two-pronged policy suggestion, proposed in this chapter, into the present Indian legal framework can be challenging. Merely burdening VASPs with obligations of a reporting entity and taxes are not sufficient. Along with an updated approach towards VASPs, a separate set of provisions or a statute is desired from the government to further solidify the VASP regulation regime, e.g., a new VASP rule under Section 73 of PMLA.[259] The decentralised nature of cryptocurrencies makes them amusing and dangerous at the same time, and money laundering is merely one aspect of this technological enigma.[260] Ergo, as Christine Lagarde noted, "policymakers should keep an open mind and work toward an even-handed regulatory framework that minimizes risks while allowing the creative process to bear fruit."[261]

257 Kenneth Pereire & Lin YingXin, *Blockchain & Cryptocurrency Laws and Regulations 2025 – Singapore*, October 25, 2024, Global Legal Insights, available at https://www.globallegalinsights.com/practice-areas/blockchain-cryptocurrency-laws-and-regulations/singapore/ (Last visited on September 20, 2025).

258 Takeshi Nagase et al., *Blockchain & Cryptocurrency Laws and Regulations 2025 – Japan*, October 25, 2024, Global Legal Insights, available at https://www.globallegalinsights.com/practice-areas/blockchain-cryptocurrency-laws-and-regulations/japan/ (Last visited on September 20, 2025).

259 The Prevention of Money Laundering Act, 2002, § 73.

260 Christine Lagarde, Addressing the Dark Side of the Crypto World, March 13, 2018, IMF Blog, available at https://www.imf.org/en/Blogs/Articles/2018/03/13/addressing-the-dark-side-of-the-crypto-world (Last visited on September 21, 2025).

261 Christine Lagarde, *An Even-handed Approach to Crypto-Assets*, April 16, 2018, IMF Blog, available at https://www.imf.org/en/Blogs/Articles/2018/04/16/an-even-handed-approach-to-crypto-assets (Last visited on September 21, 2025).

CALIBRATING THE COMPASS: A GRADED, ACTIVITY-BASED FRAMEWORK FOR INDIA'S VIRTUAL DIGITAL ASSET ECOSYSTEM

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ABSTRACT

India is at a crossroads as it faces a regulatory paradox in which the fast pace of uptake of virtual digital assets by its citizens is coupled with a piecemeal and often repressive legal system. The present system, with a highly restrictive taxation system and a layer of anti-money laundering regulations, breeds massive legal uncertainty, kills innovation, and does not sufficiently mitigate the risk factors that are paramount, namely, investor protection and market integrity. This paper holds that in order to nurture the sustainable development of virtual digital assets as a new asset class, India needs to move beyond the ad-hoc approach of its policy and adopt a customised, graded, and activity-based regulatory framework. By analysing the current legal environment of India and drawing a parallel between this environment and the international best practices in the European Union, the United States, Japan, and Singapore, it is possible to determine the global best practices in this paper. It then puts forward a customised, three-pillar framework for India. This structure includes: (1) having a transparent legislative taxonomy of virtual digital assets to avoid jurisdictional uncertainty; (2) a dynamic licensing regime of virtual digital asset service providers in terms of consumer protection and operational stability; and (3) empowering a self-regulatory body to enhance a co-operative model of public and private supervision. Through this balanced framework, India will not only be able to transition out of a state of legislative stalemate, but also to a state of economic leadership and enable the economic potential of virtual digital assets to be realised whilst protecting its financial ecosystem.

I. INTRODUCTION: NAVIGATING INDIA'S REGULATORY PARADOX

The growth of virtual digital assets ('VDAs'), the variety of crypto assets and non-fungible tokens ('NFTs') can be defined as one of the most important financial innovations of the 21st century. This international phenomenon has had a very fertile ground in India. India has experienced a remarkable increase in VDA uptake, with Indian retail investors dedicating significant capital to this emerging asset class, making the country one of the leading economic powerhouses in the global crypto market.[262] This emerging ecosystem, comprising over 230 startups, has the potential to generate substantial economic value and create employment opportunities by 2030.[263] This bottom-up expansion is, however, contrasted sharply by a top-down regulatory landscape, which can be best described as a paradox - a landscape of legislative vacuity, with a history of both a chequered and controversial past and can be described as a legal "no man's land" in which policy is simultaneous-

262 Chainalysis, *2022 Geography of Cryptocurrency Report* (2022) https://blog.chainalysis.com/reports/2022-global-crypto-adoption-index/ accessed 10 September 2025.

263 NASSCOM, 'CryptoTech Industry in India' (2021) https://nasscom.in/knowledge-center/publications/cryptotech-industry-india accessed 10 September 2025.

ly "shattered" and controversial.[264]

The main contradiction that this paradox generates and challenges this paper is the total disjuncture between the economic reality of a flourishing Indian VDA market and the continuing condition of legislative stasis and policy contradiction. The existing de facto regulatory approach is a mosaic of response actions. It primarily includes a punitive system of taxation regime (notably s 115BBH of the Income Tax Act, 1961 ('Income Tax Act') introduced by the Finance Act, 2022 ('Finance Act'))[265] and the Ministry of Finance notification expanding Prevention of Money Laundering Act, 2002 ('PMLA') obligations to certain virtual-asset activities[266]. Even though these measures can be regarded as the shift in the way, in which the government perceives the outright ban, which would be replaced by a system of control, they are insufficient and, in a way, even counterproductive. This ad-hoc methodology reaps dramatic ambiguity that is a strong deterrent to institutional investing and legitimate innovation. Better still, it does not refer to the critical risks of the VDA ecosystem, such as strong protection of consumers, market regulation, prudential regulation of intermediaries and the explicit mechanism of grievance redress.

The circumscribing factor of the regulatory problem in India is not only the lack of regulations, but an immensely rooted and unresolved collision of policy philosophy in government. The fact that the Ministry of Finance, in its regulation-by-taxation approach, implicitly recognizes VDAs as a legitimate asset category through which the state can collect substantial revenue, on the one hand, and the fact that, on the other, the Reserve Bank of India ('RBI'), the central bank and monetary authority, continually expresses profound fears of the perceived dangers VDAs present to financial stability and monetary policy, is "tacticum non grata". It is impossible to consider an asset to be a legitimate source of state revenue and an illegitimate threat that should be banned. This in-house policy is the real cause of the regulatory uncertainty that is afflicting the sector. It is this root contradiction that a sustainable policy system has to address.

Accordingly, this paper contributes to the thesis statement that to play a responsible role in promoting the development of VDAs as a new asset class, India needs to take a decisive step beyond its existing stopgap measures. It should formulate and execute a customised, active and coherent regulatory framework, which is not only graded in its execution, but also founded on the type of underlying activity. The structure should, however, be informed by the experience of mature international regulatory structures but carefully designed to suit the economy, legal, and technical context of India. In such a way, India will be able to transform regulatory paradox into a paradigm of clarity, spur innovation, safeguard consumers, and es-

264 Vidhi Centre for Legal Policy, "Regulating Cryptocurrencies in India" (2018).

265 The Income Tax Act 1961, § 115BBH (as inserted by the Finance Act, 2022) (tax on income from virtual digital assets).

266 Ministry of Finance, Notification S.O. 1072(E), *Gazette of India* (7 March 2023) (extending PMLA coverage to virtual asset activities).

tablish itself as a leader in the future of digital finance.

A. INDIAN VDA CONUNDRUM: LANDSCAPE OF LEGISLATIVE LIMINALITY

It is of high importance to undertake a stringent analysis of the present state of VDA regulation in India to develop a feasible framework in future. The landscape is not an integrative framework but a mixture of judicial declarations, fiscal laws, and financial integrity requirements, which, however important, are not a whole. This part is a critical analysis of the major elements of the Indian approach and flags the gaps in legislation that require a radical policy change.

B. A CHECKERED HISTORY: THE RBI VERSUS THE SUPREME COURT

The birth of formal regulatory involvement with VDAs in India was characterised by banishment. In April 2018, the RBI published a circular instructing all entities regulated by the central bank, such as commercial banks, to stop dealing in virtual currencies and to end the relationship with others or entities involved with such deals, establishing what was virtually equivalent to a directive that effectively required regulated entities to cease business relationships with virtual-currency service providers, thereby curtailing formal banking access to virtual asset service providers ('VASPs') and sending the sector into deep uncertainty.[267]

The landmark case of Internet and Mobile Association of India v Reserve Bank of India[268] brought before the Supreme Court of India this issue of regulatory overreach in the form of the 2018 RBI circular; in its verdict in March 2020, the Apex Court struck down this circular, marking a seminal decision on the regulation of emerging technologies. The Court utilised the doctrine of proportionality, based on the argument that the RBI, though with all of its broad powers to control the financial system, had not been able to show that the operations of VDA exchanges had resulted in any actual harm to the entities it regulates. The drastic nature of its action to eliminate banking access to the industry was found by the Court to have been a disproportionate response to any actual or potential risks in the financial system, and it therefore opened the door to more measured legislative action.

267 Reserve Bank of India, *Prohibition on dealing in Virtual Currencies* (Circular DBR.No.BP. BC.104/08.13.102/2017-18, 6 April 2018) https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11243&Mode=0 Last visited on 10 Sept 2025.

268 Internet and Mobile Association of India v. Reserve Bank of India (2020) 10 SCC 274 (Supreme Court of India, 4 March 2020).

C. THE ERA OF "REGULATION-BY-TAXATION"

After the decision of the Supreme Court, the Indian government changed its position, which was from prohibition to tacit recognition in terms of taxation. The first legislative effort aimed at defining and mainstreaming these assets in a statutory framework was the introduction of a specific and stringent tax regime of VDA by the Finance Act, which defined VDA broadly.

At the heart of this regime, though, is a policy objective more related to deterrence than facilitation. The key provisions include:

1. A FLAT 30% TAX:

The Income Tax Act, Section 115BBH,[269] levies a flat tax of thirty per cent (including a cess and surcharge) on the amount received as a result of the transfer of VDAs. This rate is imposed regardless of the total income of the investor and the time of holding the asset, and short-term and long-term gains are treated alike.[270]

2. NONE OF DEDUCTION:

The law expressly prohibits the deduction of expenditure other than the original cost of acquisition incurred in the course of the transfer of VDAs. This implies that significant transaction costs, including exchange fees or network fees (gas fees), cannot be incurred as expenses, which artificially increases the taxable income.

3. NO SET-OFF OF LOSSES:

The most severe feature of the regime, perhaps, is that there is not only no allowance of losses on transfers of VDAs against any other income, but also against gains on other VDAs. Any loss resulting from selling one VDA cannot be offset against a gain from another and cannot be carried forward to later years.

4. 1% TAX DEDUCTED AT SOURCE ('TDS'):

Section 194S of the Income Tax Act provides a 1 per cent TDS on the consideration paid on the transfer of a VDA,[271] which is applicable, subject to the condition that there are a few transaction limits. This is aimed at developing a trail of transactions to the tax authorities.

Although it is true that this tax structure was able to put VDA transactions under the formal revenue collection system, its architecture is essentially anti-cycli-

269 The Income Tax Act 1961, § 115BBH

270 The Income Tax Act 1961, § 194S

271 *Id.*

cal. The tax rate and non-deductibility of losses are very poor incentives to traders and investors, which will not encourage the operation in the formal, compliant VDA economy and will roll back the vision of building a new asset class.

D. THE ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING (AML/CFT) OVERLAY

The latest major regulatory change was made in March 2023 with the Ministry of Finance notification that placed a broad set of VDA-related activities under the PMLA.[272] The move brought actors in the VDA transactions, which are now considered VASPs under the same regulatory umbrella as the traditional financial institutions and is aimed at preventing money laundering and the funding of terrorism.

Therefore, VASPs (in India) are now obligated by law to:

> File registration with Financial Intelligence Unit-India ('FIU-IND') as a Reporting Entity.
> Perform strong Know-Your-Customer ('KYC') and Client Due Diligence ('CDD') for every user.
> Keep detailed accounts of all transactions over a given time.
> Screen transactions against suspicious activity and report Suspicious Transactions ('STRs') to the FIU-IND.

Adhere to other requirements, such as the sanctions screening and the Travel Rule of the Financial Action Task Force ('FATF').

It was a required, welcome action that moved India into the global criteria of the FATF, and closer to the key matters of national security. However, it must be mentioned that anti-money laundering and countering the financing of terrorism ('AML/CFT') compliance is merely a requirement and a sorely insufficient measure towards an integrated regulatory system. It is widely useful in addressing illicit finance risks but leaves a giant and vast regulatory void in the areas of investor protection, market integrity, prudential regulation and technological risk management and the legal characterisation of the underlying assets.

E. IDENTIFYING THE ENDURING LEGISLATIVE LACUNAE

The net impact of these developments is an environment of regulation that is full of critical loopholes. The existing structure ends up providing the elements of regulatory arbitrage and flight of capital, thus weakening its own supposed claims. The punitive tax regime, intended to prevent VDA activity, provides an incentive to Indian users to switch to non-compliant offshore platforms, where a transaction

272 Ministry of Finance, Notification S.O. 1072(E), *Gazette of India* (7 March 2023) (bringing certain VDA activities within the PMLA ambit).

becomes more difficult to trace and tax.[273] According to industry estimates, more than 90 per cent of VDA trading volume by Indians, over ₹1.03 trillion between July 2022 and December 2023, occurs in such platforms, and is frequently conducted using tools such as virtual private networks ('VPNs').[274] The tax policy is achieving this objective by driving users out of compliant VASPs registered by FIU-IND, effectively shrinking the amount of transactions that can be investigated as evidence of illicit activity, and in the process, its impact, instead of alleviating the risks that the PMLA amendments aimed to address, actually exacerbates the same risks.

This main contradiction underlines the two major gaps in the current strategy of India:

1. LACK OF CERTAIN LEGAL DESIGNATION:

VDAs are in legal limbo. No definite legislative decision has been made on whether they should be considered as securities, commodities, currencies or as a sui generis asset category. This uncertainty poses a major jurisdictional haze to regulators such as the Securities and Exchange Board of India ('SEBI'), RBI and the Ministry of Finance and hinders the establishment of a consistent and harmonised regulation approach.

2. THE ABSENCE OF A SPECIFIC LICENSING AND SUPERVISORY REGIME:

In addition to the AML/CFT purpose registration of the VASP by the FIU-IND, no overall licensing regime exists to cover VASPs. The latter regime is necessary to regulate key areas of their operations, such as minimum capital and liquidity requirements, cyber security provisions, corporate governance, fair trading practices and segmentation and custody of client assets and the setting up of effective consumer grievance redressal forums. In its absence, consumers will continue to face high fraud, mismanagement and operational risks.

II. GLOBAL BEACONS: A COMPARATIVE ANALYSIS OF INTERNATIONAL REGULATORY ARCHITECTURES

India can understand a lot by examining the various approaches adopted by such large jurisdictions as it thinks about the architecture of its own VDA framework. A comparative analysis of mature models of international regulation reveals that a diversity of regulatory philosophies and mechanisms, all of which, gives infor-

273 ESYA CENTRE (Nov 2023) (impact analysis).

274 ESYA CENTRE *Impact Assessment of TDS on the Indian VDA Market* (report, Nov 2023) (estimating offshore trading and VPN/P2P usage).

mation on the trade-off between innovation and stability and investor protection. The section will examine the European Union ('EU'), the United States, Japan and Singapore structures and combine the principles of the global standard-setting organisations.

A. THE EUROPEAN UNION'S COMPREHENSIVE MODEL: MARKETS IN CRYPTO-ASSETS (MICA)

A groundbreaking harmonised regulatory framework is the EU, which introduced its Markets in Crypto-Assets Regulation ('MiCA'), which became effective on June 23, 2023. MiCA is intended to provide a single and harmonised market-wide regulatory framework on crypto-assets, enhancing innovation and ensuring high levels of consumer protection and financial stability.[275]

MiCA architecture is constructed under the principle of the same activity, the same risk, and the same regulation. MiCA has several important characteristics:

1. TOKEN-SPECIFIC CLASSIFICATION:

MiCA does not have a one-size-fits-all approach, but classifies crypto-assets into three categories: Asset-Referenced Tokens ('ARTs'), E-Money Tokens ('EMTs'), and other crypto-assets (including utility tokens). Within every category, there is a custom-made regulatory regime based on the risk profile of that category.

2. STRICT ISSUER DISCLOSURES:

The issuers of crypto-assets are obliged to provide a comprehensive crypto-asset white paper in which they need to provide all the information regarding the project, the rights and obligations of the tokens, and the underlying technology. This document must be endorsed by a qualified national authority, and the assets must be offered to the people.

3. EXTENSIVE CRYPTO-ASSET SERVICE PROVIDER AUTHORISATION :

MiCA introduces a solid authorisation and control framework of Crypto-Asset Service Providers ('CASPs'). To work in the EU, CASPs are required to receive a license from a national competent authority that is, in turn, valid in all countries. The licensing requirements include governance, prudential protection, operational stability and client asset segregation.

275 European Parliament and Council Regulation (EU) 2023/1114 of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 [2023] OJ L 150/40.

MiCA is an unprecedented move to establish a comprehensive and foreseeable legal framework of the entire VDA ecosystem, both issuance and service delivery.

B. THE UNITED STATES' BIFURCATED AND EVOLVING APPROACH

To date, the United States has been relying on the use of the current financial laws in the VDA industry, which has created a two-tiered regulatory environment with legal ambiguity. The key factor that affects regulatory oversight is the categorisation of a particular crypto-asset as a security or a commodity.

1. SECURITIES AND EXCHANGE COMMISSION:

The Securities and Exchange Commission ('SEC') has asserted authority over crypto-assets that can satisfy the Howey test,[276] a legal test of the presence of an investment contract based on a 1946 Supreme Court case. When a VDA includes investing money in a common enterprise and anticipating returns based on the efforts of others, the crypto-assets become a security. As a result, its issuance and trading are under severe registration, disclosure and anti-fraud requirements by the SEC.

2. THE COMMODITY FUTURES TRADING COMMISSION:

Cryptocurrencies, which fail the Howey test, like bitcoin, fall under the general classification of commodities. Derivatives contracts on these assets are subject to the jurisdiction of the Commodity Futures Trading Commission ('CFTC'), and in the spot markets, to anti-fraud and anti-manipulation jurisdiction.

Such case-by-case practice has brought a lot of ambiguity in law and high-profile litigation. But a more recent and important development indicates that the trend will be toward custom-made laws. The July 2025 signing of the GENIUS Act,[277] establishes the first federal regulatory framework for stablecoins. The specific legislation requires the stablecoin issuers to have full reserve backing with highly liquid holdings (such as U.S. dollars or short-term Treasuries), disclose their reserves publicly every month, and adhere to stringent marketing regulations to guard the consumer. More importantly, under the GENIUS Act, the claims of stablecoin holders are accorded priority in the event of the insolvency of an issuer, which represents the creation of a consumer protection backstop, incorporating current legal concepts and new, asset-specific laws.

276 SEC v W J Howey Co, 328 US 293 (1946).

277 GENIUS Act of 2025, S.394 / S.1582 (119th Cong).

C. JAPAN'S PROACTIVE AND COLLABORATIVE MODEL

The most notable feature of VDA regulation in Japan is the proactive response to the issue caused by the statement of investor protection. Its structure has been modified since it was originally regulated as a payment services provider by the Payment Services Act (PSA) to a more stringent model of regulation as a financial instrument in the Financial Instruments and Exchange Act (FIEA). This places VDA exchanges under the same set of standards of conduct and consumer protection as a financial securities broker.

The formal integration of a self-regulatory organisation (SRO) is a specific and very efficient characteristic of the model of Japan. The Japan Virtual and Crypto assets Exchange Association ('JVCEA'), which is an association of licensed VDA exchanges, is officially licensed by the highest authority in Japanese financial regulation, the Financial Services Agency ('FSA').[278] The JVCEA is at the forefront of the daily regulation of the industry by:

1. CREATING SELF-REGULATORY RULES:

The JVCEA creates comprehensive operational policies to be followed by its members, including such aspects as asset listing, custody, AML policies, and the ban on privacy-enhancing coins.

2. PRE-SCREENING OF NEW ASSETS:

Before a member exchange may list a new crypto-asset, it should provide an in-depth assessment report to the JVCEA to review. This pre-assessment serves as a gatekeeping role to eliminate high-risk or fraudulent projects.

3. MONITORING AND AUDITING:

JVCEA audits and monitors its members regarding adherence to its rules and its statutory regulations.

Such a hybrid between the state and the industry enables FSA to concentrate on macro-level regulation whilst using the technical expertise of the industry to provide granular, operational regulation, establishing a reactive and dynamic regulatory environment.

D. SINGAPORE'S PRAGMATIC, ACTIVITY-BASED FRAMEWORK

Singapore has developed a reputation as a global fintech hub by having a prag-

278 Baker McKenzie / FSA press release on JVCEA recognition (2018).

matic and friendly attitude towards regulation. It is largely regulated through the Payment Services Act, 2019('Payment Services Act'), which concentrates on regulating the provision of VDA services and not on the attempt to categorise each token.

In the Payment Services Act, any organisation that offers a digital payment token ('DPT') service, such as dealing with or facilitating the exchange of DPTs, should be licensed by the Monetary Authority of Singapore ('MAS'). This activity-based licensing regime is reinforced by a heavy emphasis on risk reduction and consumer protection. Recent regulatory improvements by the MAS are:

1. STRONG AML/CFT REQUIREMENTS:

The Singapore framework concurs with the FATF standards to a full extent, which requires robust KYC, monitoring of transactions, and adherence to the Travel Rule to all licensed VASPs.

2. SEPARATING CUSTOMER ASSETS:

licensed firms must separate customer assets from their own assets, and keep them in trust with financial institutions in Singapore, with at least 90% of customer assets kept in offline cold wallets to improve their security against cyber threats.[279]

3. LIMITATIONS ON PUBLIC MARKETING:

In an attempt to deter the tendency to speculate on the DPT service, the MAS has put forward guidelines that highly prohibit the advertisement of the DPT services in the open areas, social media, and influencers.

The example of Singapore shows that a flexible, activity-based structure can be used to successfully handle risks without stifling the development of the underlying technology.

E. SYNTHESISING GLOBAL STANDARDS: FATF AND FSB

Behind these national practices are the principles and norms that are published by the international organisations.

F. FINANCIAL ACTION TASK FORCE ('FATF'):

FATF has created international, binding principles to fight against the misappli-

279 Monetary Authority of Singapore, *Guidelines on Consumer Protection Measures by Digital Payment Token Service Providers* (PS-G03) (Apr 2024)

cation of virtual assets in money laundering and terrorist financing. The main requirements that it has on VASPs are carrying out customer due diligence, record keeping, and suspicious transaction reporting. The most notable of those is Recommendation, which encompasses the so-called Travel Rule, stipulating that VASPs are to receive, store, and transfer the necessary originator and beneficiary information and VDA transfers.[280]

1. FINANCIAL STABILITY BOARD ('FSB'):

FSB is concerned with the macroeconomic and financial risks linked to crypto-assets. It proposes action-oriented and coherent worldwide regulatory reaction founded on the idea of equal activity, equal danger, equal control. The FSB has issued high-level principles on the regulation of crypto-asset activity and global stablecoin, acknowledging that global oversight is required to avert regulatory arbitrage and protect the global financial system.

Such international norms place a very important foundation on national regulators and bring some global uniformity and collaboration in dealing with the cross-border issues presented by VDAs.

III. CHARTING THE COURSE FOR INDIA: A PROPOSED GRADED REGULATORY FRAMEWORK

Based on the legislative shortcomings analysis of India and the educative precedents of the world regulatory leaders, this part suggests a specific multi-dimensional policy framework in India. The framework would be proactive, coherent and adaptive, and change India, with its present regulatory ambiguity, into the future of clarity and sustainable growth. The general philosophy of the proposed architecture is the globally accepted principle of same activity, same risk, and same regulation, but carefully adapted to the Indian scenario. It is based on three pillars, which include a definite taxonomy of VDAs, universal licensing of VASPs and the empowerment of a collaborative self-regulatory organisation.

A. PILLAR 1: AN EXPLICIT TAXONOMICAL PROCESS ON VIRTUAL DIGITAL ASSETS.

The first step to a coherent regulatory regime is to eliminate the legal uncer-

280 FATF, *Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (FATF, Oct 2021)

tainty on the categorisation of the VDAs. The existing, generic definition under the Income Tax Act could not be used to achieve a subtle regulation; a legislative amendment is needed to provide a clear taxonomy, which is to impose regulatory oversight on the basis of the economic role and risk profile of the asset. This would result in the end of the jurisdictional wrangle between SEBI, RBI, and other institutions and the possible specialised and expert-guided regulation. A three-part taxonomy[281] is suggested:

1. SECURITY TOKENS:

Victoria de Arbitre de Proprietate de Empresas, i.e. any VDA conferring or advertising ownership in a company, evidence indebtedness, or rights to profits, and satisfying the functional definition of a security under the Securities Contracts (Regulation) Act, 1956,[282] must expressly be described as a security token. The entire activity associated with security tokens, such as the issuance (e.g., Security Token Offerings), trading, and custody of such tokens, should be under the direct jurisdiction of SEBI. This would enable India to utilise the decades of experience that SEBI has in regulating markets, disclosure standards and investor protection to regulate this part of the VDA market well.

2. PAYMENT TOKENS:

VDAs assembled with an intention to serve as a medium of exchange or pegged to the price of a fiat currency (i.e., stablecoins), must be considered payment tokens. These assets ought to be subject to regulation by the RBI, given their possible effect on monetary policy, payment systems and financial stability;[283] the regulatory framework of the payment tokens must be informed by the U.S. GENIUS Act,[284] with special attention on:

A. STRICT RESERVE REQUIREMENT:

Requiring the issuers of India-centric stablecoins to have 1:1 reserves of high-qual-

281 FinLaw, 'Cryptocurrency Law in India: Current Legal Status and Regulatory Landscape 2025' (FinLaw Blog, 2025) https://finlaw.in/blog/cryptocurrency-law-in-india-current-legal-status-and-regulatory-landscape-2025 accessed 10 September 2025.

282 The Securities Contracts (Regulation) Act, 1956, § 2(h).

283 International Journal of Future Multidisciplinary Research (IJFMR), 'Cryptocurrency and Indian Legal Landscape' (Vol 5 Issue 3, May 2025) https://www.ijfmr.com/papers/2025/3/46742.pdf accessed 10 September 2025.

284 Reuters, 'India resists full crypto framework, fears systemic risks, document shows' (10 September 2025) https://www.reuters.com/world/india/india-resists-full-crypto-framework-fears-systemic-risks-document-shows-2025-09-10 accessed 10 September 2025.

ity liquid assets (e.g., cash deposits in periodic commercial banks or government bonds).

B. TRANSPARENCY AND AUDITS:

This should be accompanied by periodic, publicly reported, attestations of reserves by independent auditors.

C. OPERATIONAL OVERSIGHT:

Managing their compatibility with their already in place payment and settlement systems to achieve interoperability and stability.

3. UTILITY TOKENS AND OTHER VDAS:

This group would include VDAs that grant access to a particular product or service on a blockchain-based platform (utility tokens) and other crypto-assets, such as Bitcoin, that are not pursuant to the security or payment token classification.[285] A new, unique regulatory system must be created for this variety of people. This may be monitored by a combined committee of regulators (with representatives of SEBI, RBI and the Ministry of Electronics and Information Technology) or by a newly established Digital Assets Authority. In this category, the emphasis should be placed on the promotion of innovation and the provision of baseline consumer protection by means of mandatory and clear disclosures, just as in the case of the white paper requirements of MiCA 13 of the EU.

B. PILLAR 2: A COMPREHENSIVE, ACTIVITY-BASED VASP LICENSING REGIME

The second pillar is an outlook beyond the existing PMLA registration model to a full-fledged activity-based licensing framework of all VASPs in India. This would be a regime based on the strong frameworks of Singapore and the EU,[286] in which

285 Nishith Desai Associates, 'Tokens in India: Classification and Legal Implications' (2020) https://www.nishithdesai.com/Content/document/pdf/Articles/201013_A_India.pdf accessed 10 September 2025.

286 TaxGuru, 'Cryptocurrencies as Securities: Post-GIFT City Regulations and SEBI's Viewpoint' (TaxGuru, 2025) https://taxguru.in/sebi/cryptocurrencies-securities-post-gift-city-regulations-sebis-viewpoint.html accessed 10 September 2025.

all the intermediaries have high operational and financial resilience standards that would gain the trust and offer consumer protection.

A licensing authority should be a designated primary regulator (or the suggested joint authority), and its requirements should be tiered according to the scale and nature of the VASPs' activities. All licensed VASPs should have core requirements that include:[287]

1. PRUDENTIAL AND FINANCIAL REQUIREMENTS:

The creation of minimum net worth, capital adequacy and liquidity requirements to make VASPs stable to market shocks and be a going concern.

2. SOUND CONSUMER PROTECTION SYSTEMS:

A. ASSET SEGREGATION:

Requiring a very high degree of customer asset segregation of customer assets versus the VASP's own funds, and that a large majority (e.g. ninety per cent, as in Singapore) of the customer assets be in secure, offline cold storage.

B. CLEAR RISK DISCLOSURES:

An obligation to have VASPs issue clear, salient and easy to comprehend risk warnings to all users regarding the volatility and risk of VDA trading.

C. GRIEVANCE REDRESSAL:

Requirement of the development of a proper mechanism for resolving customer complaints and customer disputes.

D. MARKETING AND ADVERTISING RESTRICTIONS:

Introducing an advertising code of conduct, like the one in Singapore, to ensure against misleading advertisement that undermines the risks of investment.

E. Strict Cybersecurity and Governance Requirements:

Specifying standards of minimum requirements of cybersecurity infrastructure, data protection measures and corporate governance, such as fitness and propriety

287 Shankar IAS, 'Virtual Digital Asset (VDA) Regulations in India' (Shankar IAS Parliament, May 2025) https://www.shankariasparliament.com/blogs/pdf/virtual-digital-asset-vda-regulations-in-india accessed 10 September 2025.

of directors and key managerial staff.

F. FULL FATF COMPLIANCE:

This will ensure full compliance with all obligations under the AML/CFT requirements as stipulated by the PMLA and the full adoption of the Travel Rule to increase the transparency of transactions.

C. PILLAR 3: EMPOWERING A SELF-REGULATORYORGANISATION (SRO)

Formal recognition of an industry-based SRO based on the expertise of the successful JVCEA in Japan is the last pillar of the suggested structure because the market of VDA is dynamic and technologically complex in nature.[288] An SRO, which functions under the overarching jurisdiction of the statutory regulators, can offer the technical expertise and nimbleness that traditional regulatory bodies might be deficient in.

This would be a better supervisory system because it is a public-private partnership that would be more efficient and responsive. The mandate of the SRO would encompass;

1. ESTABLISHING INDUSTRY-SPECIFIC STANDARDS:

Working together with regulators to create technical criteria on the listing of new crypto-assets, best practices on custody solutions and a comprehensive code of conduct on marketing.

2. FIRST-LEVEL SUPERVISION AND AUDITS:

Periodically auditing its member VASPs about their adherence to the SRO rules as well as the statutory rules and reporting outcomes to the primary regulator.

3. ENABLING INFORMATION EXCHANGE:

As a key node in distributing information about emerging threats, vulnerabilities and best practices, amongst industry participants, and between the industry and regulatory bodies.

4. TRAINING AND CERTIFICATION:

The intervention includes the creation of training and certification programs to

288 Financial Services Agency (Japan), 'Amendments to the Payment Services Act and Financial Instruments and Exchange Act' (FSA, April 2025) https://www.fsa.go.jp/en/news/2025/20250410_2/01.pdf accessed 10 September 2025.

be undertaken by compliance professionals in the VDA industry to create capacity and promote a high degree of professional behaviour.

Delegating such granular, operational-level supervisory duties to an empowered SRO will enable statutory regulators such as SEBI and the RBI to focus on their main business of macro-prudential oversight and systemic risk management, as well as enforcement and develop a more effective and holistic regulatory ecosystem.

An implementation cycle of this three-pillar framework can replace the negative loop of feedback that currently exists. A conspicuous taxonomical jurisprudence (Pillar 1) will provide the trust needed to attract institutional capital and encourage local innovation. A sound licencing regime (Pillar 2) will assist in nurturing consumer trust and confidence in the market with the aim of protecting them in case of fraud and operational failures. SRO empowerment (Pillar 3) will enable the industry itself to become a participant in the process of high standards, which will cause the ecosystem to be more adaptive and resilient. Together, these elements, such as clarity, trust, and resilience, will establish a formal, on-shore VDA market. A bigger and more open domestic market will, in its turn, establish a bigger and more viable tax base and will make it much easier to control AML/CFT, hence, meeting both the objectives of the government, i.e., the generation of revenue and the national security. It is the most direct and sustainable pathway to the development of the new asset class in India via this positive feedback loop.

IV. CONCLUSION: FROM AMBIGUITY TO ASCENDANCY

An acute and intractable ambiguity has plagued the life of VDAs in India. The current regulatory framework, a reactive ad hoc blend of punitive taxation and selective AML/CFT regulation, would be a shaky foundation upon which an industry, which is going to expand exponentially, would be set. This does not only suffocate innovation and drives the offshoring frontiers to the limit of their economic activity but also subjects the Indian consumers and the financial system, in general, to uncompromising risks. The policy paradox that prevails now, where a state power desires to tax a certain property and other desires to ban it, has created a legislative game of cat and mouse, which is not in the long-run interest of the stakeholder. The moment has come to be decisive, progressive and policy intervention wise coherent.

Like this paper has argued, prohibition or half-baked solutions are not the way forward; instead, it is a progressive, planned and activity-based regulation structure. By incorporating the experience of the most successful international jurisdictions and applying them to the circumstances of India, it will be possible to build a strong and sustainable ecosystem. The proposed three pillar framework provides a practical roadmap of such transformation in a concise manner.

A Clear VDA Taxonomy will remove the jurisdictional mess of having the regulatory authority being vested in the expert organisations, like SEBI and the RBI, that will be determined by the economic role of the asset and therefore offer legal certainty.

An extensive VASP licencing framework will instil high standards of all the market intermediaries and assure prudential soundness, operational stability and most importantly robust protection to the Indian consumer.

The Empowerment of a self-regulatory organisation will be an important collaboration between the public and the private, leveraging experience in the industry to offer agile, ground-level regulation and allowing the statutory regulators to focus on systemic resilience.

Only with this restrained action can India be able to plot a paradigm shift out of its current state of regulatory uncertainty to being a world leader in the digital asset economy. Not merely a risk mitigation structure, but a climate of transparency and trust that can be established can unlock the latent innovative and economic promise in this new asset class. It is a strategy to attract capital, nurture local talent and build a global-class digital infrastructure. It is the only way which India can go to ensure that the world will not consider it a desperate partner, but the leader of the future of the global finance market.


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