

## Cryptocurrency Taxation and Anti-Money Laundering Regulation: An Indian Legal Perspective

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### Abstract

There have been many challenges that have arisen due to the growth in cryptocurrency and other virtual digital currencies in India. These virtual currencies help to conduct innovative types of digital transactions and investments; however, the decentralised nature of virtual currencies poses many challenges for the detection of tax evasion and illegal financial transactions. The regulatory framework that has been chosen by the government in India is based on the taxation and anti-money laundering laws instead of legalization of private cryptocurrencies as legal tender. The inclusion of the provisions regarding taxation of such virtual digital assets (VDA) by the Income-tax Act along with the provision of tax on specific income earned from the transfer of VDA and tax deduction at source provisions is quite essential. On the contrary, the specified activities concerning the virtual digital assets have also been included under the Prevention of Money Laundering Act, 2002. In this regard, the present research aims at making a critical analysis of the legal framework of India in terms of cryptocurrency taxation and anti-money laundering regulations, with an emphasis on the analysis of the provisions of the Income-tax Act, Prevention of Money Laundering Act and the regulatory roles of the Financial Intelligence Unit-India. The research focuses on the issues created due to pseudonymous transactions, offshore exchanges, cross-border transactions, tax evasion and money laundering through the use of digital assets. The paper mentions that while there have been increased regulatory measures in India concerning their tax policies and money laundering laws, there is fragmentation in the regulatory process and technological advancement which makes enforcement difficult.

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### 1. INTRODUCTION

The advent of cryptocurrency has drastically changed the way of conducting digital transactions. Cryptocurrency works through decentralized blockchain network systems and does not follow the traditional system of transactions conducted by the central bank and financial institutions. It facilitates the direct transfer of funds from one user to another, whereas the process of verification of such transactions is accomplished using cryptographic technology. The rapid development of cryptocurrency marketplaces has generated a lot of prospects in terms of investments and technological innovations. However, their distinct features have posed new challenges pertaining to taxation, money laundering, financial transparency and regulation. In the context of India, the

emergence of cryptocurrencies has proved to be quite a complicated matter from a legal perspective. The Indian government has failed to follow the usual way of accepting private cryptocurrencies as a means of payment in accordance with the law. India has gradually created a legal regulation mechanism, regulating the effects of virtual digital assets transactions. The tax system has been one of the major instruments to regulate the economic activity linked to cryptocurrencies. The creation of a special tax regime for virtual digital assets under the Income-tax Act reflects attempts to make transactions with cryptocurrencies taxable and traceable. The issues at stake in the regulation, nevertheless, go further than tax revenue. The anonymity provided by

blockchain addresses, the employment of several wallets, person-to-person transfers, and access to foreign cryptocurrency exchanges could cause problems regarding identifying the identities of those concerned and tracking funds. Cryptocurrency can, thus, not only be utilized for legitimate investments and business but also be employed as a means of obscuring the source or destination of the ill-gotten gains. This has led to the expansion of India's anti-money laundering regime to some particular actions related to virtual digital assets and the placing of compliance duties on relevant service providers. This, brings us to the dual and connected yet separate objectives of the Indian approach: proper taxation of cryptocurrency income and prevention of any abuse of digital assets for money laundering and other financial crimes. In this context, the current study analyses the Indian laws on taxation and anti-money laundering regulations relating to cryptocurrencies. The study analyses the key legislative provisions and the challenges faced in implementing such regulations. Moreover, the study questions if there is a need for coordination between tax and anti-money laundering legislation to have an effective regulatory regime for virtual digital assets.

## 2. CRYPTOCURRENCY AND THE INDIAN LEGAL FRAMEWORK

Cryptocurrency may be understood as a class of digital assets that rely on cryptography and distributed ledgers to validate and record transactions. Bitcoin, Ethereum and other cryptocurrencies are traded via blockchain systems where transactions are recorded on a decentralized ledger instead of recording transactions with centralized financial organizations. Such a structure makes crypto-currency different from the traditional currency and presents distinct legal issues as far as ownership, trading, taxation and regulation are concerned. Even though cryptocurrencies can be highly valuable from the economic perspective, their legal status depends on the regulation regimes of respective jurisdictions. The legal position relating to private cryptocurrencies in India has evolved in a slow and gradual manner. There have been reservations on the part of the Reserve Bank of India regarding the monetary, financial and consumer dangers posed by virtual currencies. The Supreme Court of India in its judgment in *Internet and Mobile Association of India v Reserve Bank of India* had upheld the legality of the circular issued by the Reserve Bank of India wherein the Reserve Bank of India had placed restrictions on regulated entities regarding virtual currencies. However, the judgment has not legalized private cryptocurrencies. One of the noteworthy developments was the incorporation of the idea of a "virtual digital asset" (VDA) into the Income-tax Act. According to Section 2(47A), this statutory term includes some digital value representations, including some cryptocurrencies. The introduction of such a term was necessary since it made possible for the tax legislation to regulate transactions using VDAs without having to acknowledge their monetary character. Hence, the approach of the legislation is to consider the economic and taxable effect of the transaction rather than granting the VDA monetary character. The Indian legal system further extended this beyond tax regulations and included some operations involving VDAs within the purview of the Prevention of Money Laundering Act, 2002 (PMLA). It became clear from this development that cryptocurrency service providers can function as intermediaries within the financial system, in some cases. Such an approach corresponds to the regulatory attitude of the country towards cryptocurrency. Unlike most jurisdictions,

which adopt a single statute in order to regulate the use of cryptocurrency, different aspects of the digital asset are regulated using existing laws regarding taxation, anti-money laundering and financial regulation. While such an approach offers statutory tools to regulators in response to new threats, it might result in fragmented regulation. India's legal approach should thus be seen as an approach of controlled recognition and not of unrestricted acceptance. Cryptocurrency does not qualify as sovereign money, but transactions made in VDAs have serious legal and tax implications. This difference is critical to understand India's approach: the law can regulate and tax an economic activity without legalizing the underlying asset.

## 3. TAXATION OF CRYPTOCURRENCY IN INDIA

India has adopted a special tax regime for virtual digital assets (VDAs) under the Finance Act, 2022. This regime has proved to be a major shift in the treatment of transactions related to cryptocurrency in Indian income-tax law. As against the creation of a special taxation statute for cryptocurrency, the legislature has included certain provisions in the Income-tax Act, 1961. This special tax regime mainly deals with income from the transfer of virtual digital assets.

### 3.1 *Taxation under Section 115BBH*

Income from the transfer of virtual digital assets is subject to special tax treatment under section 115BBH. The income which falls under this provision is taxed at a rate of 30 per cent without taking into consideration the statutory requirements. It does not matter how the taxpayer is holding the asset and thus, is important for individuals as well as persons dealing in VDAs. Moreover, there is also an allowance as regards the deductions that may be made with respect to the income from the VDA. In general, the sole deduction allowed with respect to the income from the VDA is the cost of acquiring the VDA. No expenses incurred during the process of transfer can be deducted when computing the taxable income from the transfer. There is thus a major difference between taxing the VDA income and taxing several other forms of income. An important aspect in respect of the restrictions is the one with respect to the losses that can be made. No loss suffered as a result of the transfer of one VDA can be set-off against the income received from another VDA transaction. No loss arising from the VDA transfer can be carried forward and deducted against the income in future assessment years.

### 3.2 *Tax Deduction at Source*

Section 194S provides for the tax deduction at source regime in respect of consideration paid on transfer of a VDA. The tax needs to be deducted at one per cent rate, depending upon the conditions and thresholds as specified in the provision. This provision seeks to facilitate the process of reporting at transaction level and assist the tax administration in acquiring the information relating to the transfer of VDAs. In case of the transactions involving cryptocurrencies in the context of exchanges, intermediaries and peer-to-peer, the problem of determining the party liable to deduct the tax may arise where there are multiple parties involved in the transaction. The involvement of offshore platforms in the transactions makes the enforcement all the more difficult due to limited control over such offshore entities by the Indian tax administration.

### 3.3 *Different Forms of VDA Transaction*

There are different methods by which cryptocurrency can be traded. This includes sales of the cryptocurrency, exchange of one form of the digital asset for another, exchange in exchange for goods and services rendered, mining of the VDA, staking and gifting. The tax treatment may be different based on the

way and manner in which the cryptocurrency is exchanged. Mining and staking pose questions of the timing of the revenue and valuation of the asset, while the gifting of cryptocurrencies poses considerations of the provisions regarding the gift and the relationship between the giver and receiver. These cases highlight the need for the tax legislation to work in tandem with the provisions of the Income-tax Act.

### **3.4 Compliance Difficulties**

Successful application of cryptocurrency tax is contingent on the existence of accurate transaction records. The taxpayer might hold various types of cryptocurrencies on different exchanges and through private wallets and engage in multiple transactions transferring assets from one wallet to another outside the scope of traditional financial institutions. Determining the cost of acquisition, date of acquisition, consideration and taxable gain becomes complicated as a result. International transactions pose another challenge. Indian taxpayers may conduct transactions through foreign exchanges or decentralised networks which do not record data in a format easily accessible by Indian tax agencies. In addition, pseudonymity of wallet addresses may complicate linking blockchain transactions to particular taxpayers. All this proves that the efficiency of cryptocurrency taxation is not only dependent on the tax rate but also on the effectiveness of reporting, identification and information exchange. The Indian taxation regime has developed a clear statutory base for taxing transfers of VDAs. However, its effectiveness depends on the ability to properly identify and account for transactions conducted by the taxpayer. Technological changes and evolving nature of activities related to cryptocurrencies will further put the effectiveness of the tax regime to test.

## **4. CRYPTOCURRENCY AND ANTI-MONEY LAUNDERING REGULATIONS IN INDIA**

As the use of VDA becomes more widespread, there have been apprehensions regarding the chances of criminals hiding their ill-gotten gains using virtual transactions. Despite the fact that blockchain creates an enduring record of all the transactions, it would be necessary to identify the users and the origin of money, which is a specialized task. To this end, India has expanded its anti-money laundering regulations to cover certain activities related to virtual digital assets.

### **4.1 Application of the Prevention of Money Laundering Act, 2002**

The Prevention of Money Laundering Act, 2002 (PMLA) is the key legislation dealing with money laundering in India. An important step happened on 7 March 2023, when the Ministry of Finance made certain VDA activities covered by Section 2(1)(sa)(vi) of the PMLA. Such activities are buying or selling VDAs for fiat money, exchanging one VDA for another, transferring VDAs, managing VDAs, and taking part in or providing financial services concerning offering and sale of VDAs. In case such activities are conducted during business for another person or on his/her behalf, then such activities will be within the scope of the notification. The notification does not mean that all cryptocurrency holders and transactions performed in their personal wallets will become subjected to the same requirements as the reporting entity. Its application depends on the type of activity and statutory requirements.

### **4.2 Obligations of VDA Service Providers**

The service providers listed under the framework qualify as reporting entities under the PMLA and should, as such, meet their statutory and regulatory obligations in regard to the customer identification and due diligence, verification of beneficial ownership where necessary, keeping of transaction

records, internal procedures and reporting of prescribed transactions to the Financial Intelligence Unit–India (FIU-IND). Customer due diligence plays an important role in establishing who uses a particular platform as well as whether the transactions made through the platform are consistent with the customer's financial history. In cases where the transactions made are suspicious, there could be a need to report regardless of the fact that the transaction alone is unable to prove that an offence has been committed. The duty therefore lies with the service provider to put up proper monitoring mechanisms.

The above requirement plays an important preventative role. As exchanges and custodial platforms can be points of interaction between digital assets and the traditional financial system, the record keeping of transactions can assist in uncovering any suspicious transactions and connecting the wallets to the customers involved and possibly financial offences.

### **4.3 Role of FIU-IND**

FIU-IND, established under the Ministry of Finance, is the agency responsible for receiving, analysing, and disseminating financial intelligence concerning suspicious and other prescribed transactions. The VDA sector functions include the implementation of the reporting-entity regime, guidance, and the imposition of action against non-compliant entities. The recently issued AML/CTF Guidelines by FIU-IND on 8 January 2026 are evidence that regulation is still evolving in India. These AML/CTF Guidelines include the compliance rules applicable to the service providers working in the VDA industry. Appropriate implementation of the AML/CTF Guidelines assumes conducting a risk-based customer assessment, monitoring transactions, training staff, and establishing the internal controls relevant to the risk associated with digital assets. The case shows that registration and compliance are real obligations but not administrative procedures. Thus, in January 2025, FIU-IND has imposed a fine of ₹9.27 crore on Bybit Fintech Limited for failing to comply with its obligations under the PMLA and the relevant regulations and guidelines. It is a proof of readiness to impose penalties on the operators of cryptocurrency services in India.

### **4.4 Offshore Exchanges and Cross-Border Enforcement**

Cryptocurrency exchanges based outside the territory are a significant threat in terms of regulatory compliance. Users of India can transact on such offshore exchanges, thus making it difficult to obtain information on customers, transactions monitoring, and compliance. Block chain-based transaction having a cross-border element may be another hurdle in investigations involving more than one jurisdiction. Being incorporated abroad cannot per se determine the compliance obligation for such entity since relevant laws and activities should be considered. The registration and enforcement regime created by FIU-IND aims to regulate VDA service providers working on the Indian market. However, efficient supervision implies international cooperation, quick financial information exchange, and coordination between local and foreign authorities. Therefore, India's AML regime has created an essential basis for supervision of cryptocurrency-based services. However, its effectiveness in the long run will rely on enforcement, technical capabilities, and the capacity to deal with cross-border transactions.

## **5. LEGAL CHALLENGES IN THE INDIAN FRAMEWORK**

- The Challenge of Tracing Taxpayers: In cryptocurrency trading, the use of digital wallets masks the identity of the person conducting the transaction. The problem is

further exacerbated where multiple digital wallets are involved.

- **International Transactions:** Cryptocurrency can be sent across international borders without the involvement of banks. It is therefore difficult to obtain the record of transactions and implement Indian law enforcement and conduct investigations in foreign countries.
- **Offshore Exchanges for Cryptocurrency:** Indian investors may be utilizing exchanges which function offshore and are located abroad from India. It becomes difficult for the authorities to trace the identity of these customers.
- **Decentralized Finance (DeFi):** Such decentralized platforms are based on smart contracts which do not have any intermediary performing the duty of verification of the customer. The person responsible for regulatory compliance becomes hard to identify.
- **Valuation and Tax Determination:** Frequent trading, volatility, and transactions in different cryptocurrencies makes tax determination and maintenance of correct record of transactions difficult.
- **Set-off and Carry-forward Prohibition:** Under Section 115BBH, there is prohibition on set-off and carry-forward of losses from transactions in VDA. There may be situations when a taxpayer may incur losses in other VDA transactions and still incur a tax liability.
- **Tax Evasion and Concealment:** Taxpayers may evade taxes by not disclosing cryptocurrency income or concealing transactions through the use of various wallets and platforms. Identification of such transactions requires proper reporting and verification.
- **Risk of Money Laundering:** Proceeds of Crime may be laundered by transferring funds through multiple wallets or platforms or other transaction structures to obscure their source.
- **Overlapping Issues between Taxation Law and AML Regulations:** While the Income-tax Department and FIU-IND both have statutory mandates to deal with AML issues, lack of coordination or overlap in terms of reporting can increase compliance burdens and delays in the investigative process.
- **Issue of Privacy and Data Protection:** There is extensive collection of data concerning cryptocurrency transactions, which poses privacy risks and potential misuse of data.
- **Technological Constraints:** Blockchain analytics, along with well-trained investigators and proper digital evidences, is required for effective supervision.
- **Regulatory Uncertainty:** Various cryptocurrency operations such as mining, staking and decentralized finance could give rise to regulatory uncertainty on tax and reporting obligations among others. Regulatory guidance is needed for consistency in compliance.
- **No International Cooperation:** Variations in national laws and requirements for reporting may enable any transactions to take place through jurisdictions having poor supervision. International cooperation is needed for effective enforcement.
- **Due Process:** Automated monitoring systems may lead to false positives or wrongful designation of transactions as suspicious. Verification processes are needed to ensure no legitimate user is affected.

Generally, the above issues highlight that the cryptocurrency regulations in India need more coordination between the tax

officials and AML regulators, regulatory clarity for new developments in the digital asset space, international cooperation and privacy and due process protection.

## **6. TAXATION AND AML – NEED FOR AN INTEGRATED REGULATORY APPROACH**

There are different purposes of cryptocurrency taxation and anti-money laundering regulation, however, both rely upon accurate transaction data and cooperation between the regulators. Taxation deals with the determination and payment of the due tax payable out of the income, whereas anti-money laundering regulation is about the prevention and detection of the movement of proceeds earned through criminal activity. It can lead to better enforcement and also not duplicate the compliance requirements unnecessarily.

Cooperation among the Income-tax Department, Financial Intelligence Unit–India (FIU-IND), Reserve Bank of India and others is a must for the regulation of cryptocurrencies. There are specific statutory responsibilities for each regulator; however, proper information sharing methods can ensure that unidentified income and suspicious transactions and financial offences are detected. This cooperation shall have to be within the ambit of the relevant laws. Standardised reporting requirements for cryptocurrency exchanges and other regulated service providers will additionally increase the effectiveness of the regulation. Uniform reports may help to minimise differences in accounting information, to identify the relevant transactions and to comply. Effective due diligence and beneficial ownership verification are just as important because regulators should be able to link digital transactions to people behind it. Such measures should be conducted in line with the respective legal requirements and character of service provided. Technology is also important in terms of increasing the effectiveness of the regulation. The blockchain analysis can help regulators to trace digital transactions, to detect unusual patterns and connections between different wallets. But at the same time, technology should support but not substitute investigation, evidence collection and fair decision making. Technology-based analysis cannot be taken as evidence of tax evasion or money laundering. The Indian Government should also increase international cooperation to handle the threat presented by offshore cryptocurrency exchanges and cross-border transactions. International cooperation in terms of foreign regulators and financial intelligence units could help India gain access to relevant documentation as well as conduct investigations involving several jurisdictions. Moreover, clear guidelines regarding the taxation and reporting regime of mining, staking, decentralized finance and crypto to crypto transactions will also make the situation less uncertain for taxpayers and encourage voluntary compliance. On the other hand, greater supervision should be balanced by considerations of privacy, procedural justice, as well as the interests of cryptocurrency users. The regulatory bodies need to use appropriate monitoring mechanisms based on risk assessments and take measures to ensure that financial information is protected against any unauthorized disclosure. Furthermore, taxpayers and service providers should get an opportunity to fix reporting mistakes and challenge regulatory actions. Therefore, such a coordinated approach would help India deal with the issues of tax evasion and money laundering without hampering the development of the digital economy. It is important that every cryptocurrency transaction should not be treated suspiciously.

## **7. RECOMMENDATIONS**

India needs to create a more consistent and harmonized regulation of virtual digital assets through improving the interface between income-tax laws and anti-money laundering provisions. While there are laws that have provisions for taxing transactions involving VDAs and for the surveillance of specified financial service providers, additional guidance will assist in dealing with any uncertainties brought about by technological advances. The government needs to provide clear guidelines regarding taxation of the cryptocurrency mining process, staking, decentralized finance and cryptocurrency-to-cryptocurrency transactions. Such guidelines will help taxpayers meet their legal requirements and avoid disputes with the tax authorities. Legal coordination needs to be enhanced between the Income-tax Department and FIU-IND through proper information sharing and reporting procedures. Cryptocurrency exchanges and other service providers should be able to keep transaction records and carry out necessary customer due diligence requirements and suspicious transaction reporting obligations. Moreover, India needs to increase its cooperation on an international level to ensure that offshore cryptocurrency exchanges adhere to legal obligations and proper transaction information is obtained concerning cross-border transactions. Blockchain technology analytics, specialized training and digital investigations would also enhance this process. Finally, the legislation should ensure that privacy of the individuals is protected, fair procedures are in place and a proportional approach is adopted. Proper safeguards in order to avoid the abuse of the system and at the same time not to overburden legitimate entities with unnecessary requirements could be ensured through proper regulation.

## 8. CONCLUSION

The advent of cryptocurrencies has brought in a new dimension to investing and finance, posing serious threats to taxation and anti-money laundering regulations. In response, the Indian government has brought virtual digital assets into the ambit of income tax law and amended the Prevention of Money Laundering Act, 2002 to cover certain acts performed in relation to such virtual assets. It is an indication of increased regulation without the recognition of private cryptocurrencies as legal tender. Taxation under Section 115BBH and the deduction at source through Section 194S are aimed at improving tax compliance and reporting. Likewise, the

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application of PMLA in relation to certain VDA service providers would help with customer identification, transaction monitoring and financial intelligence. The success of these measures, however, would depend upon their effective implementation. Problems like pseudonymous nature of transactions, offshore exchanges, transfer abroad, difficulty in valuation and decentralized systems still pose issues for regulatory authorities. The present Indian system can serve as a good starting point, but taxation and AML laws will never be effective by themselves. There is a need for better coordination between the Income-tax Department, FIU-IND and other relevant agencies in order to take into consideration common interests and at the same time not to infringe on their separate powers. International cooperation and more technological capacities are equally important in this regard. However, any successful system regulating cryptocurrencies should be based on a proper combination of financial controls and privacy, procedures and economic activity. It means that it should not rely solely on restrictive tax regimes and monitoring measures. In order to prevent tax evasion and money laundering and also provide legal certainty to the parties, India needs a coordinated approach to digital-asset activities.

## Author Contribution

The author conceptualized the research, conducted the literature review and doctrinal analysis, drafted the manuscript, and finalised the article for submission.

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Conflict of interest declared none.

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