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Virtual Digital Assets in India: From Gray Area to Regulated Reality

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The future of digital currency in India stands at a critical juncture with retail investors pouring $6.6 billion into cryptocurrencies and related assets. We are witnessing a remarkable transformation as India leads global grassroots crypto adoption, potentially creating 800,000 jobs by 2030. This surge in popularity comes alongside significant regulatory developments, particularly the Income Tax Bill, 2025, which for the first time clearly classifies Virtual Digital Assets (VDAs) as property and capital assets within the legal framework.

Digital currency in India has evolved from regulatory ambiguity to structured oversight since 2022, when the government introduced a 30% capital gains tax and 1% TDS on VDA transactions exceeding ₹10,000. Despite these regulatory efforts, considerable trading has moved offshore, resulting in tax revenue losses exceeding ₹2,488 crore. Additionally, the question "is crypto legal in India?" has become increasingly relevant as the Income Tax department investigates potential tax evasion through investments in virtual digital assets. Furthermore, the RBI digital currency initiative aims to provide a state-backed alternative to cash, potentially reducing the 15-17% expense associated with paper currency over its four-year lifecycle. With user numbers expected to reach 107.30 million by 2025, Indian digital currency stands at the threshold of mainstream adoption, balancing innovation with regulatory compliance.

Defining Virtual Digital Assets in the Indian Context

Virtual digital assets (VDAs) represent a new class of digital value existing entirely in electronic form. As India's cryptocurrency ecosystem evolves, understanding precisely what constitutes a VDA becomes essential for investors, regulators, and policymakers alike.

Cryptocurrencies, NFTs, and Tokenized Assets

Virtual digital assets encompass multiple digital value representations that operate on blockchain technology. Cryptocurrencies like Bitcoin and Ethereum function as mediums of exchange, stores of value, and units of account without central authority control. Unlike traditional currencies, these assets exist solely in digital environments, secured through cryptographic methods.

Non-fungible tokens (NFTs) represent another significant VDA category. These unique digital identifiers recorded on blockchains certify ownership and authenticity of specific digital or physical items. NFTs have gained tremendous popularity in India, primarily in digital art forms, though they can represent virtually any unique item.

Tokenized assets extend the VDA concept further by digitally representing tangible assets like real estate on blockchain networks, allowing them to be traded online. Notably, the definition excludes NFTs whose transfer results in legally enforceable ownership transfers of underlying tangible assets.

Section 47A and the Income Tax Act Definition

The Finance Act of 2022 formally introduced VDAs into India's legal framework through Section 2(47A) of the Income Tax Act, 1961. This definition encompasses any information, code, number, or token (excluding Indian or foreign currency) generated through cryptographic means that provides digital value representation.

The legal definition stipulates three essential characteristics: these assets must be transferable, storable, or tradable electronically; function as stores of value or units of account; and possess inherent value representations. Consequently, this broad definition captures cryptocurrencies, NFTs, and other blockchain-based financial instruments while excluding certain items like gift cards, loyalty points, and website subscriptions.

Use Cases: Payments, Investments, and Digital Ownership

VDAs serve multiple functions within India's evolving digital economy:

- Medium of Exchange: Many cryptocurrencies facilitate transactions without traditional banking intermediaries
- Investment Vehicles: VDAs function as alternative investment assets, potentially storing value similar to traditional investments
- Governance Tools: Utility tokens help manage decentralized networks and protocols
- Digital Ownership Verification: NFTs establish verifiable ownership of digital assets ranging from artwork to virtual real estate

Moreover, the VDA ecosystem enables decentralized finance (DeFi) applications, cross-border transactions, and digital wealth building opportunities. As Indians spend increasing time in virtual environments, the significance of digital ownership approaches that of physical asset ownership, marking a fundamental shift in how value is perceived and transferred in modern India.

Legal Recognition and Regulatory Milestones Since 2022

India's regulatory landscape for digital assets underwent significant transformation beginning in 2022, establishing clearer parameters for previously unregulated virtual currencies and tokens.

30% Flat Tax and 1% TDS under Section 115BBH

The Finance Act of 2022 introduced Section 115BBH of the Income Tax Act, implementing a 30% flat tax on income from VDA transfers effective April 1, 2022. This tax applies regardless of the investor's income slab and permits no deductions except the cost of acquisition. Importantly, the framework prohibits offsetting losses from VDA investments against other income sources or carrying them forward to subsequent years.

Simultaneously, Section 194S established a 1% Tax Deducted at Source (TDS) requirement on VDA transactions exceeding ₹50,000 (or ₹10,000 in specific cases) effective July 1, 2022. This measure aims to track digital asset transactions, hindering potential money laundering and tax evasion. However, these stringent tax policies reportedly drove over 300 Web3 startups to relocate operations outside India.

Inclusion under PMLA: March 2023 Notification

The regulatory framework expanded substantially when the Ministry of Finance issued a notification on March 7, 2023, bringing VDAs under the Prevention of Money Laundering Act (PMLA). This notification encompassed five key activities: exchanges between VDAs and fiat currencies, exchanges between different VDAs, transfers of VDAs, safekeeping of VDAs, and participation in VDA offerings.

Subsequently, cryptocurrency exchanges and traders must adhere to Know Your Customer (KYC) protocols and submit suspicious transaction reports to the Financial Intelligence Unit. By January 31, 2023, the Enforcement Directorate had already attached proceeds of crime worth ₹936 crores related to cryptocurrency under PMLA.

Supreme Court Ruling on RBI Ban (2018–2020)

Prior to these developments, the Reserve Bank of India issued a circular on April 6, 2018, prohibiting banks from facilitating VDA transactions. However, on March 4, 2020, the Supreme Court overturned this ban in a landmark 180-page judgment.

The Court deemed the RBI's circular "disproportionate," noting the central bank could not demonstrate that regulated entities had "suffered any loss or adverse effect" from interactions with VDA exchanges. Essentially, the Court affirmed that absent comprehensive legislation, outright prohibition was unjustified. This ruling preceded the subsequent regulatory frameworks and continues to influence India's evolving approach toward digital assets.

Global Influence on India’s Digital Asset Policy

International regulatory frameworks profoundly shape the evolution of India's virtual digital asset policies, creating a complex interplay between global standards and local implementation.

EU's MiCA Framework and Consumer Protection

The European Union's Markets in Crypto-Assets (MiCA) regulation stands as the world's most advanced comprehensive digital asset framework, establishing clear guidelines for crypto-asset service providers. MiCA requires issuers to publish white papers, maintain capital reserves, and implement robust consumer protection measures. Indian regulators closely monitor this approach, particularly its consumer protection elements which align with India's concerns about retail investor vulnerability.

For instance, MiCA's stringent requirements for stablecoin issuers offer a potential blueprint as India develops its own framework. The EU's emphasis on transparency aligns with the direction of Indian digital currency regulations, especially regarding disclosure requirements and operational standards for exchanges.

US SEC Classification of Tokens as Securities

The United States Securities and Exchange Commission's approach significantly influences global crypto regulations, including India's evolving framework. The SEC applies the Howey Test to determine whether digital tokens constitute securities, focusing on whether investors contribute money expecting profits from others' efforts.

This classification has broader implications for the future of digital currency in India, as Indian regulators grapple with similar questions about which VDAs should fall under securities regulations. The SEC's aggressive enforcement actions against crypto exchanges offer cautionary lessons for Indian regulators still defining their oversight boundaries. Meanwhile, the question "is crypto legal in India?" remains complex partly because Indian authorities are watching how US regulatory clarity develops.

India's Role in G20 and Cross-border Alignment

India's G20 presidency in 2023 elevated its role in shaping global crypto policy coordination. Under India's leadership, G20 nations endorsed common regulatory standards for virtual digital assets, emphasizing appropriate taxation and anti-money laundering measures.

The Indian government actively advocated for a coordinated global regulatory approach, recognizing that cross-border nature of VDAs requires international cooperation. The Financial Stability Board's recommendations during India's presidency now inform RBI digital currency development and VDA oversight. Accordingly, India balances implementing domestic frameworks while contributing to international consensus-building, ensuring Indian digital currency regulations remain compatible with emerging global standards.

Challenges in Enforcement and User Behavior

Despite regulatory efforts to govern virtual digital assets, significant challenges persist in enforcement and user behavior that threaten the future of digital currency in India.

Offshore Trading and VPN Workarounds

The stringent taxation regime has inadvertently pushed trading activities offshore. Between July 2022 and December 2023, Indians traded over ₹1.03 trillion worth of VDAs on non-compliant platforms, with only 9% of the estimated ₹1.12 trillion in VDAs held on domestic exchanges. This offshore migration resulted in uncollected VDA tax revenue of ₹2,488 crore. Even more concerning, between December 2023 and October 2024, trading volume on offshore platforms surged to ₹2.63 trillion, with uncollected TDS exceeding ₹60 billion.

Attempts to block access to non-compliant platforms have proven largely ineffective. After initial URL blocking, trade volumes on these exchanges quickly rebounded, with web traffic increasing by 57%. Users easily circumvent restrictions through virtual private networks (VPNs), mirror platforms, and alternative non-compliant exchanges. Major VPN providers like Nord VPN, Express VPN, and Surfshark responded to Indian regulations by relocating servers outside India while continuing to service Indian users.

Non-compliance with Schedule VDA in ITRs

The punitive 30% capital gains tax and 1% TDS, absent regulatory clarity, have driven substantial capital outflow. Over 90% of VDA trading volume, amounting to approximately ₹600,000 crore, now occurs outside India's tax jurisdiction. This situation mirrors historical examples where high customs duties on gold imports fueled smuggling and resulted in significant tax losses.

Cybersecurity Risks and Exchange Hacks

The vulnerability of Indian digital currency infrastructure was starkly demonstrated in 2024 when hackers stole INR 19407.50 million from a major Indian exchange. Stolen crypto funds increased by 21.07% year-over-year in 2024, reaching INR 185.64 billion. In response, Indian exchanges improved cybersecurity measures and established insurance funds to protect against future attacks.

Nevertheless, the absence of enforceable cybersecurity standards and investor redressal mechanisms continues to expose consumers to theft, scams, and market volatility. The cryptocurrency ecosystem has altered the cyber threat landscape by enabling services that facilitate laundering and obfuscation of funds without leaving traceable trails.

Conclusion

Virtual Digital Assets have traversed a remarkable journey from regulatory ambiguity to structured oversight within India's financial ecosystem. Therefore, understanding this transformation requires recognition of both the substantial progress made since 2022 and the considerable challenges that persist. The introduction of Section 115 BBH with its 30% flat tax, alongside the 1% TDS mechanism, undoubtedly established the first clear legal framework for digital assets. Additionally, the inclusion of VDAs under the Prevention of Money Laundering Act further legitimized these assets while simultaneously imposing necessary compliance requirements.

Nevertheless, these regulatory measures have produced unintended consequences. Specifically, the migration of trading activities to offshore platforms has resulted in substantial tax revenue losses exceeding ₹2,488 crore. This exodus undermines domestic oversight capabilities and creates significant enforcement challenges. Equally important, cybersecurity vulnerabilities continue to pose serious threats to investor funds, as evidenced by major exchange hacks resulting in losses of billions of rupees.

The global context certainly influences India's regulatory approach. The EU's MiCA framework offers valuable lessons regarding consumer protection, while the US SEC's classification methodologies provide insights into securities regulation. India's leadership role in G20 discussions underscores its commitment to developing internationally aligned standards for digital assets.

Looking forward, policymakers face the complex task of balancing innovation with investor protection. Consequently, future regulatory iterations must address offshore trading workarounds, strengthen cybersecurity requirements, and create more nuanced taxation structures. India stands uniquely positioned to become a global leader in responsible VDA regulation, provided regulatory frameworks evolve to acknowledge market realities while maintaining necessary oversight.

The question "Is crypto legal in India?" now has a clearer answer than ever before – yes, but within specific regulatory parameters that continue to develop. This evolution represents a fundamental shift from prohibition attempts toward structured integration into the financial system. Although challenges remain substantial, the foundation for a regulated VDA ecosystem now exists, marking significant progress toward legitimizing these digital assets within India's economic framework.