

Crypto Crimes: Indian Cryptocurrency Regulation and Legal Difficulties

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ABSTRACT

Globally, including in India, cryptocurrencies have become more popular. This has resulted in a rise in crimes associated to cryptocurrencies and presented serious legal issues. India's legal system is complicated and constantly changing; in 2020, the Supreme Court reversed the Reserve Bank of India's 2018 prohibition. The regulatory structure is still unclear, however. Money laundering, tax evasion, and other economic crimes find cryptocurrency transactions appealing due to their anonymity and pseudonymity, which is made worse by the absence of clear restrictions. The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 is one of the steps the Indian government has suggested to outlaw private cryptocurrencies and establish a Central Bank Digital Currency (CBDC). The Prevention of Money Laundering Act (PMLA) now covers cryptocurrencies as well, forcing exchanges to report suspicious activity and carry out KYC processes. Discussions over striking a balance between innovation and regulation persist notwithstanding these initiatives. In light of the complicated regulatory landscape, the Securities and Exchange Board of India (SEBI) has proposed a multi-regulator architecture to regulate cryptocurrencies. In addition to promoting innovation and safeguarding investors, India's approach to cryptocurrency regulation must handle legal issues. The future of cryptocurrencies in India and their involvement in economic crimes will be shaped by ongoing attempts to create a strong regulatory framework.

Keywords: Cryptocurrencies, legal challenges, regulation, economic crimes, RBI, and investor protection.

INTRODUCTION

The emergence of cryptocurrencies, which provide previously unheard-of chances for economic innovation and inclusivity, represents a radical change in the financial environment. The quick spread of cryptocurrencies in India has sparked discussions and arguments regarding their possible advantages and drawbacks. Many people are drawn to the promise of decentralisation and anonymity, but these same features also present serious difficulties for law enforcement and regulatory agencies, especially when it comes to financial crimes like money laundering and tax evasion. In 2018, the Reserve Bank of India (RBI) banned banks that handled cryptocurrency transactions in an effort to reduce the dangers involved. This choice was made as a preventative step to shield the established financial system from the hazards and perceived volatility of digital currency. The bitcoin community, however, strongly opposed this general prohibition, claiming that it hindered economic growth and innovation. The RBI's restriction was overturned by the Supreme Court of India in 2020, a historic ruling that allowed cryptocurrency activities in the nation—albeit in a grey area of regulation. The main obstacle to regulating cryptocurrencies is their pseudonymous character, which makes it very difficult to track down transactions and identify those engaged in illicit activity. The blockchain technology behind cryptocurrencies permits a high level of privacy, in contrast to conventional banking systems where transactions may be watched and monitored. Although this function protects user privacy, criminals use it to dodge taxes, promote money laundering, and carry out other economic crimes covertly. Because there isn't a single organization in charge of monitoring or managing the system, the decentralised nature of cryptocurrencies makes regulatory efforts even more difficult. The Indian government has been attempting to develop a legal framework that can both mitigate the dangers and promote the potential advantages of cryptocurrencies in response to these difficulties. The planned Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 and the addition of cryptocurrencies to the Prevention of Money Laundering Act (PMLA) are noteworthy developments. By improving transaction transparency and reducing illegal activity inside the cryptocurrency ecosystem, these policies seek to strike a compromise between the need for innovation and the need for regulatory control. The complexity and volatility of the cryptocurrency industry are highlighted by the continuous regulatory initiatives, underscoring the need of a well-rounded strategy that promotes innovation while guaranteeing strict control.

THE EVOLUTION OF CRYPTOCURRENCY REGULATION IN INDIA

India's bitcoin regulatory odyssey has been marked by uncertainty, quick changes, and a never-ending struggle between control and innovation. The views of legislators and regulatory bodies changed along with the bitcoin ecosystem.

- **Early Days and Initial Skepticism**

Bitcoin and other cryptocurrencies started to gain international interest in the early 2010s. Financial institutions and regulators in India first responded with scepticism and caution. The public has received many warnings about the dangers of investing in cryptocurrencies from the Reserve Bank of India (RBI) and other financial institutions. Concerns over the threats to the conventional banking system, the possibility of financial losses, and the absence of consumer protection were brought to light by these warnings.

- **The 2018 RBI Ban**

The RBI's 2018 restriction on financial institutions handling cryptocurrencies marked a sea change in India's cryptocurrency regulations. In an effort to stop the increasing usage of cryptocurrencies amid concerns about financial instability and illegal activity, this regulation essentially forbade banks from supporting transactions using digital currency. A number of exchanges and companies involved in digital currencies were forced to close as a result of the ban, which was a major setback for India's developing cryptocurrency sector.

- **Current Regulatory Landscape**

The regulatory landscape for cryptocurrencies in India is still unclear despite the Supreme Court's decision. To control the usage of cryptocurrencies, the government has been developing extensive laws. One important piece of proposed legislation that attempts to address the legal status of cryptocurrencies, provide a framework for the development of a Central Bank Digital Currency (CBDC), and outlaw private cryptocurrencies is the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021.

- **Key Legislative Developments**

Among stakeholders, the proposed measure has generated a great deal of discussion and controversy. It is a two-pronged strategy that prohibits private cryptocurrencies while establishing regulations for CBDCs. This strategy represents the government's goal to maximise the advantages of digital currency and blockchain technology while reducing the dangers connected with their usage. In order to stop abuse and safeguard customers, the measure also highlights the need of strict regulatory control.

CHALLENGES POSED BY CRYPTOCURRENCIES IN COMBATING ECONOMIC CRIMES

Cryptocurrencies, with their promise of decentralized and anonymous transactions, present a unique set of challenges in combating economic crimes. These digital assets have transformed the financial landscape, offering both opportunities and risks.

- **Anonymity and Pseudonymity**

One of the defining features of cryptocurrencies is their ability to provide a high degree of privacy. Transactions are conducted using cryptographic techniques, and users are identified by their wallet addresses rather than personal information. While this offers privacy and security benefits, it also poses significant challenges for law enforcement agencies. The anonymity and pseudonymity of cryptocurrency transactions make it difficult to trace the flow of funds and identify individuals involved in illicit activities.

- **Money Laundering**

The use of cryptocurrencies for money laundering, in which monies gained illegally are transformed into digital currency to conceal their source, is growing. Cryptocurrencies are appealing instruments for money laundering due to their simplicity of cross-border transfers and the lax regulatory scrutiny in certain countries. Large quantities of money may be moved swiftly and covertly by criminals, making it difficult for law enforcement to follow and stop these transactions.

- **Tax Evasion**

Cryptocurrencies' decentralised structure makes tax enforcement more difficult. By concealing assets, underreporting income, and engaging in transactions outside of the established financial system, individuals and companies may utilise cryptocurrency to avoid paying taxes. It is difficult for tax authorities to identify and deal with tax evasion schemes employing digital currencies due to a lack of transparency and regulatory monitoring.

- **Fraud and Scams**

Scams and fraudulent activity have increased in the bitcoin sector. The variety of fraudulent actions is wide, ranging from phishing attempts and hacking events to Ponzi schemes and phoney initial coin offerings (ICOs). The danger of fraud is increased in the absence of strong regulatory frameworks and consumer protection measures, making investors susceptible to large financial losses.

- **Regulatory Gaps**

Regulators have difficulties due to the often changing nature of cryptocurrencies. Conventional regulatory frameworks often lack the necessary tools to handle the special features of digital currencies. Regulatory arbitrage, in which people and organisations take advantage of regulatory loopholes to carry out illegal acts, is made possible by the absence of consistent legislation across several countries. Additionally, this fragmentation makes it more difficult for nations to coordinate and cooperate in the fight against crimes using cryptocurrency.

- **Technological Complexity**

Regulators and law enforcement organisations have additional challenges due to the technical complexity of blockchain technology and cryptocurrencies. It takes certain knowledge and experience to comprehend the complexities of digital wallets, smart contracts, and decentralised exchanges. Because technology is always changing, regulators need to stay up with new advancements by updating their expertise and plans.

THE ROLE OF REGULATORY BODIES: RBI, SEBI, AND GOVERNMENT LEGISLATION

Regulating the cryptocurrency sector in India involves multiple stakeholders, each with distinct roles and responsibilities. Among these, the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the central government play pivotal roles in shaping the regulatory landscape.

- **Reserve Bank of India (RBI)**

As India's central bank, the RBI has taken the lead in regulating cryptocurrencies. The possible effects of digital currencies on the conventional banking system and financial stability have been a main worry. The RBI made a significant move in 2018 when it issued a circular that essentially prohibited banks from handling transactions involving cryptocurrencies. The purpose of this restriction was to shield customers from any financial losses and reduce the hazards connected to the unchecked expansion of digital currency. However, the cryptocurrency community strongly objected to this action, which resulted in legal challenges. The RBI's prohibition was overturned by the Supreme Court of India in March 2020 on the grounds that it was unreasonable and without enough proof of damage. The RBI was forced to reevaluate its strategy for regulating cryptocurrencies as a result of this landmark ruling.

As a controlled substitute for private cryptocurrencies, the RBI has been investigating the creation of a Central Bank Digital Currency (CBDC). The goal of a CBDC, which is issued and managed by the RBI, is to integrate the advantages of virtual currencies with the security and supervision of conventional financial institutions. The RBI's dedication to adjusting to the changing financial environment is shown by its continuing research and pilot programs in this field.

- **SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)**

The production and trade of cryptocurrency assets that can be considered securities are closely monitored by SEBI, the Indian securities market regulator. Protecting investors' interests, maintaining market openness, and encouraging ethical business practices are all part of SEBI's purpose. SEBI's participation is crucial in developing a framework that handles the risks and possible abuses related with cryptocurrencies because of their complexity.

The possibility of fraud and market manipulation in the bitcoin market is one of SEBI's main worries. SEBI has been pushing for strict regulatory measures, such as the establishment of strong KYC and AML protocols for cryptocurrency exchanges, in order to reduce these risks. These steps are intended to preserve market integrity, safeguard investors, and increase transparency.

- **Government Legislation**

In order to create a thorough legal framework that covers all facets of digital currencies, the Indian government's involvement in cryptocurrency regulation is essential. An important legislative attempt to clarify the legal position of cryptocurrencies in India is the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021. The measure intends to provide a framework for the formation of a CBDC while outlawing private cryptocurrencies. The government's intention to strike a balance between the need for innovation and the need for regulatory control is reflected in the proposed law. The government aims to reduce the hazards of uncontrolled digital currencies, such as their possible use for illegal activities, by outlawing private cryptocurrencies. Simultaneously, the launch of a CBDC seeks to provide a safe, regulated substitute that makes use of blockchain technology's advantages.

- **Interagency Collaboration**

Cooperation between different government agencies and regulatory authorities is necessary for the cryptocurrency industry to be effectively regulated. A coordinated strategy is required to manage the dangers and difficulties connected with cryptocurrencies due to their complexity and rapid evolution. Developing thorough regulatory frameworks, exchanging information, and guaranteeing uniform enforcement of rules all depend on interagency cooperation.

A start in this approach is the planned multi-regulator structure, which involves RBI, SEBI, and other pertinent institutions. This strategy acknowledges the many ways that cryptocurrencies affect all facets of the financial system and seeks to provide a unified regulatory framework that fosters innovation while guaranteeing consumer safety and financial stability.

INTERNATIONAL PERSPECTIVES AND COMPARATIVE ANALYSIS

• United States

The regulation of cryptocurrencies in the US is characterised by a disjointed approach, with many federal and state bodies having their own regulations. Cryptocurrencies that meet the definition of securities are governed by the Securities and Exchange Commission (SEC), which enforces stringent compliance regulations. With an emphasis on preventing fraud and market manipulation, the Commodity Futures Trading Commission (CFTC) regulates cryptocurrencies that are categorised as commodities. Anti-money laundering (AML) laws are also enforced by the Financial Crimes Enforcement Network (FinCEN), which mandates that cryptocurrency exchanges have strong Know Your Customer (KYC) protocols in place. State-level laws differ greatly; some, like New York, have extensive licensing laws like the BitLicense, while others have laxer or nonexistent laws. Businesses who operate beyond state boundaries may face difficulties as a result of this disjointed approach, but it also serves as a testing ground for regulations, offering important insights into what works and what doesn't.

• European Union

The European Union (EU) has taken significant steps towards creating a unified regulatory framework for cryptocurrencies. The proposed Markets in Crypto-Assets (MiCA) regulation aims to provide legal certainty, protect consumers, and ensure financial stability. MiCA covers a broad range of activities, including the issuance of cryptocurrencies, crypto-asset service providers, and market abuses. By harmonizing regulations across member states, MiCA seeks to foster innovation while preventing regulatory arbitrage.

In addition to MiCA, the EU's Fifth Anti-Money Laundering Directive (5AMLD) extends AML and KYC requirements to cryptocurrency exchanges and wallet providers. This directive aims to enhance transparency and traceability of cryptocurrency transactions, reducing the risks of money laundering and terrorist financing. The EU's comprehensive approach serves as a model for balancing innovation with robust regulatory oversight.

• Japan

Japan is one of the pioneers in cryptocurrency regulation, having recognized Bitcoin as a legal method of payment as early as 2017. The country's Financial Services Agency (FSA) oversees cryptocurrency exchanges, requiring them to register and comply with stringent AML and KYC regulations. Japan's regulatory framework emphasizes consumer protection, market integrity, and financial stability.

The FSA's proactive approach has helped foster a secure and innovative cryptocurrency market in Japan. The agency's emphasis on transparency and investor protection has been instrumental in maintaining public trust in the crypto market. Japan's experience highlights the importance of early and proactive regulation in fostering a healthy cryptocurrency ecosystem.

• Singapore

Singapore has emerged as a global hub for cryptocurrency innovation, thanks to its progressive regulatory environment. The Monetary Authority of Singapore (MAS) regulates cryptocurrencies under the Payment Services Act (PSA), which provides a comprehensive framework for licensing, AML/KYC compliance, and consumer protection. The PSA's flexible approach allows for innovation while ensuring regulatory oversight.

Singapore's balanced regulatory regime has attracted numerous cryptocurrency businesses and startups, fostering a vibrant fintech ecosystem. The country's emphasis on clarity, flexibility, and collaboration with industry stakeholders serves as a model for other jurisdictions looking to balance innovation with regulation.

SUGGESTIONS

• Developing a Comprehensive Legal Framework

One of the primary needs for the future is the establishment of a comprehensive legal framework that clearly defines the status and treatment of cryptocurrencies. This framework should address the classification of cryptocurrencies, delineate the roles and responsibilities of regulatory bodies, and provide guidelines for the operation of cryptocurrency exchanges and service providers. By providing legal clarity, such a framework can enhance investor confidence and promote the growth of the cryptocurrency market within a secure and regulated environment.

• Balancing Innovation with Oversight

Regulation should aim to strike a balance between promoting innovation and ensuring adequate oversight. This involves creating an environment that encourages technological advancements and the development of new financial products while implementing safeguards to prevent misuse and protect consumers. Regulatory sandbox initiatives, where new technologies can be tested in a controlled environment, can be an effective tool for balancing these objectives. These sandboxes allow regulators to observe and understand emerging technologies and their implications before rolling out broader regulations.

• Enhancing Consumer Protection

Consumer protection must be a cornerstone of any regulatory framework. This includes implementing robust Know Your Customer (KYC) and Anti-Money Laundering (AML) measures to prevent fraud and illicit activities. Additionally, regulations should mandate clear disclosures from cryptocurrency

exchanges regarding the risks associated with investing in digital assets. Establishing a formal mechanism for consumer grievances and dispute resolution will also help build trust and protect investors.

- **Promoting Transparency and Accountability**

Transparency and accountability are crucial for maintaining the integrity of the cryptocurrency market. Regulatory bodies should require cryptocurrency exchanges to adhere to stringent reporting standards, including regular audits and the publication of financial statements. Such measures can help detect and prevent market manipulation and other fraudulent activities. Encouraging transparency will also facilitate better market analysis and informed decision-making by investors.

- **International Cooperation and Harmonization**

Given the global nature of cryptocurrencies, international cooperation and harmonization of regulations are essential. India should actively participate in global forums and work with international regulatory bodies to develop common standards and best practices for cryptocurrency regulation. This collaboration can help address cross-border challenges, such as money laundering and regulatory arbitrage, and ensure that India's regulatory framework is aligned with global norms.

- **Leveraging Technological Innovations**

Regulators should leverage technological innovations to enhance their oversight capabilities. Blockchain analytics and artificial intelligence (AI) can be powerful tools for monitoring and analyzing cryptocurrency transactions. These technologies can help detect suspicious activities, trace the flow of funds, and identify potential risks in real-time. By adopting advanced technologies, regulators can stay ahead of emerging threats and ensure a secure and transparent cryptocurrency market.

- **Educational Initiatives and Public Awareness**

Public awareness and education are critical components of an effective regulatory strategy. Regulators and policymakers should invest in educational initiatives to inform the public about the benefits and risks of cryptocurrencies. By promoting financial literacy and awareness, they can empower individuals to make informed decisions and protect themselves from potential scams and fraudulent schemes. Educational campaigns can also help demystify cryptocurrencies and reduce misconceptions, fostering a more informed and engaged investor community.

- **Preparing for Future Challenges**

As the cryptocurrency market continues to evolve, new challenges are likely to emerge. Regulators must be prepared to adapt to these changes and address new risks as they arise. This includes monitoring developments in areas such as decentralized finance (DeFi), non-fungible tokens (NFTs), and other emerging technologies. By staying vigilant and proactive, regulators can ensure that their frameworks remain relevant and effective in a rapidly changing landscape.

CONCLUSION

With early scepticism, a contentious prohibition, and continuous legislative attempts to create a complete framework, cryptocurrency law in India has undergone substantial change. The trip has been motivated by the need to strike a compromise between the need to preserve financial stability and stop illegal activity and the advantages of innovation and economic inclusion provided by cryptocurrencies. A turning point was reached in 2020 when the Supreme Court intervened to reverse the RBI's prohibition, emphasising the need for regulatory proportionality and clarity in order to handle the difficulties presented by digital currencies. Important regulatory organisations like the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the national government continue to play a critical role as India strives to improve its regulatory strategy. Their joint efforts are focused on developing rules that uphold the integrity of the financial system, safeguard customers, and encourage openness. Although it has generated a lot of discussion among stakeholders, the proposed Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 is an important step in the direction of legal certainty. India can learn a lot from viewpoints from across the world. In order to control cryptocurrencies, nations like Singapore, Japan, the US, and the EU have implemented a variety of policies that strike a balance between strict regulation and innovation. These incidents highlight the significance of standardised laws, consumer protection strategies, and the use of cutting-edge technology to track and control the hazards connected to virtual currencies. India can create a strong and flexible regulatory framework that takes into account its own economic and technical environment by taking inspiration from these global examples. In the future, India's capacity to promote innovation while maintaining sufficient control will determine how well it regulates cryptocurrencies. India can establish a safe and prosperous cryptocurrency economy by encouraging openness, strengthening consumer protection, and using technology developments. The future of digital currencies in India will be greatly influenced by ongoing communication and cooperation with international regulatory organisations. India has the ability to capitalise on the advantages of cryptocurrencies while preserving its financial system and protecting its people via careful and aggressive regulation.

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