



## The Intersection of PMLA and Digital Assets: Enforcement Challenges in India's Crypto Landscape



### Introduction

In an increasingly interconnected world, where national borders seem to blur in the digital ether, the rise of cryptocurrencies has presented governments with a multifaceted challenge. Hailed by some as the future of finance and decried by others as a destabilizing force, these decentralized digital assets have carved out a unique space, operating often beyond the traditional financial guardrails. India, a nation navigating its own complex relationship with digital innovation, has chosen a formidable weapon to grapple with the crypto phenomenon: the PMLA<sup>1</sup>.

This move, while seemingly a logical step to curb illicit activities, casts a wide net, classifying cryptocurrency trading under the same stringent ambit as arms trafficking, terrorism financing, and narcotics. The PMLA is not merely a punitive law; it's a special legislation designed to not only punish the perpetrator but also to dismantle the entire ecosystem supporting the crime, extending its reach to those who knowingly or even unknowingly deal with the proceeds of crime. **Section 3 of the PMLA**, with its sweeping language of "whoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party...", grants investigative agencies immense power to trace and attach assets, regardless of how **"legitimate"** the income used for their acquisition might



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appear. Imagine a scenario where a consumer unknowingly purchases a counterfeit luxury product, the proceeds of which fuel a "scheduled offence" under PMLA – that seemingly innocent purchase could render them an accessory, and their property, however legitimately earned, could be attached.

This framework, rigorous, non-bailable, and carrying mandatory sentences, is now being rigorously applied to the world of virtual digital assets. The logic is clear: if an activity poses a risk of facilitating money laundering, it must be subjected to the most potent tools available. **RBI**<sup>2</sup> has long voiced its concerns, equating crypto to a "Ponzi scheme" and highlighting its potential threat to national financial stability and sovereignty. The PMLA's inclusion of crypto aims to address this systemic risk head-on.

However, the path forward is anything but straightforward. The inherent nature of cryptocurrency, built on underlying code rather than tangible fiat, presents a unique challenge to the PMLA's core concept of "proceeds of crime, including its concealment, possession, acquisition or use and projecting or claiming it as untainted property." The<sup>1</sup> very anonymity and untraceable nature of some crypto transactions, coupled with the difficulty in definitively identifying ownership, make mapping the "tainted" nature of these digital assets a Herculean task. Yet, the government believes it has found its Achilles' heel: the inevitable point of interaction between the crypto world and traditional fiat currency. It is at this crucial juncture, where digital assets must converge with real-world money, that the PMLA steps in, aiming to designate such exchanges as "tainted transactions" and thus, **"tainted property."**

### **The Paradox of Non-Recognition and Enforcement Grip**

Herein lies one of the most intriguing paradoxes of India's approach: cryptocurrencies are currently not recognized as legal tender. While it is legal to trade and hold them, they cannot be used for everyday transactions or as a replacement for the Indian Rupee. This absence of definitive legal classification makes the PMLA's task even more daunting. How does one effectively curtail an activity that exists in a regulatory grey area? The lack of clear definitions and a comprehensive legal framework creates a vacuum, forcing enforcement agencies to apply existing laws to a fundamentally different asset class. This can lead to ambiguities, operational challenges for businesses, and legal uncertainty for individuals.

### **Recent Developments and a Glimmer of Clarity?**

Despite this foundational ambiguity, recent developments clearly signal India's intent to bring the crypto world under stricter oversight. In March 2023, the Indian government declared entities dealing in **VDAs**<sup>3</sup>, including crypto exchanges and related intermediaries,





as "reporting entities" under the PMLA. This crucial step imposed stringent **KYC**<sup>4</sup>, **AML**<sup>5</sup>, and **CFT**<sup>6</sup> requirements on them.

**FIU-IND**<sup>7</sup> has been at the forefront of this enforcement. They have mandated cryptocurrency exchanges to significantly strengthen their KYC processes, including updating user details and initiating fresh KYC for accounts older than 18 months. Furthermore, offshore crypto exchanges that were previously operating outside the regulatory purview are now facing immense pressure to register with FIU-IND or face severe enforcement actions. In a significant move, several major offshore exchanges, including Binance and KuCoin, faced show cause notices and had their URLs and mobile apps blocked in India in December 2023 for non-compliance with the PMLA. Binance, in particular, has faced substantial penalties for PMLA violations. The Enforcement Directorate (ED) has also demonstrated its sharpened teeth, seizing large amounts of crypto in recent investigations, including a massive ₹1,646 crore (approximately \$197 million) in a single fraud case earlier this year. These actions underscore the government's unwavering commitment to enforcing the PMLA in the crypto sphere, irrespective of the ongoing debate about legal recognition.

### Is This a Step Towards Recognition?

The very act of bringing cryptocurrency transactions under the PMLA, while not an explicit recognition as legal tender, is undeniably a significant step towards formalizing their existence within the Indian legal and financial landscape. By imposing rigorous AML/CFT obligations, the government is, in essence, acknowledging the economic significance of these assets and the need to regulate them. This move might be seen as a precursor to a more comprehensive regulatory framework, answering some of the surrounding questions regarding their legal standing.

The ongoing discussions around the proposed Cryptocurrency and **Regulation of Official Digital Currency Bill**, though not yet passed, also point towards a potential shift from an outright ban on private cryptocurrencies to a more nuanced regulatory approach that prioritizes investor protection and clear guidelines for exchanges.

However, the effectiveness of this **"surgical strike"** in truly deterring illicit crypto trading remains to be seen. The Enforcement Directorate's own statistics, while impressive in terms of assets attached, reveal a complex picture. As of March 31, 2022, the ED had attached assets worth over ₹1,04,702 crores across 5,422 investigations. However, with only 400 arrests and a mere 25 convictions in PMLA cases by that date, the numbers suggest a significant gap between initial seizures and ultimate judicial outcomes. This disproportionate ratio, where the average value of assets attached per convict is astronomically high, raises





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questions about the efficiency of the investigative and prosecutorial process. The inclusion of the complex crypto market is bound to further inflate these figures, pushing the ED into uncharted territory.

The fundamental question that looms large is whether the Enforcement Directorate can effectively balance its rigorous investigative mandate with the imperative to protect unknowing participants in the crypto market. Many individuals, perhaps through indirect investments via friends, fund managers, or even trading houses, may have unknowingly become entangled in this web of digital assets now deemed "tainted property." The onus is now undeniably on these individuals to prove the legitimate source of their crypto holdings, a daunting task in a world built on pseudonymity and decentralized ledgers.

The clampdown on crypto, while driven by genuine concerns for financial stability and national security, presents a unique socio-economic challenge. As India continues to navigate the evolving landscape of digital finance, the true measure of the PMLA's success will not just be in the volume of assets attached or the number of cases initiated, but in its ability to foster a secure and transparent digital economy without unduly penalizing the innocent or stifling legitimate innovation. The blindfolded lady of justice, with her sword and balance, faces perhaps her most intricate challenge yet in the labyrinthine world of cryptocurrency. The journey from non-recognition to regulated acceptance, or at least a tightly controlled existence, is a long and winding one, with each PMLA action adding another chapter to this unfolding narrative.

### **Conclusion: Navigating the Murky Waters of Crypto Regulation**

While India's government, through the Union Budget of 2022, introduced **Section 271C of the IT Act<sup>8</sup>** to levy a flat 30% tax on capital income from (VDAs) and a 1% TDS on every transaction, this recognition for taxation purposes has not yet translated into comprehensive regulatory clarity. This paradoxical stance—taxing VDAs while withholding explicit legal recognition—underscores the complexity of integrating a decentralized asset class into a traditional financial system. The WazirX case serves as a stark reminder of the vulnerabilities inherent in this ambiguous environment. In 2022, the Enforcement Directorate (ED) exposed how the platform allegedly facilitated transactions worth over ₹2,790 crore linked to Chinese loan apps, routed through shell companies using crypto wallets. This investigation highlighted severe lapses in KYC compliance and a critical lack of transparency in identifying beneficial owners, starkly illustrating the regulatory and enforcement challenges under the PMLA.

Crucially, India's robust actions are aligning with global best practices, particularly the **(FATF) guidelines<sup>9</sup>**. These international rules emphasize licensing, stringent customer checks, and







adherence to the "Travel Rule," which mandates the sharing of originator and beneficiary information in crypto transactions. The FATF also focuses on addressing risks posed by decentralized systems, non-custodial wallets, and peer-to-peer transfers—all designed to combat illicit fund flows. India's recent VDA policies, particularly the VASP Notification and FIU Guidelines, closely mirror FATF's definitions and compliance expectations. The Supreme Court's affirmation in **Vijay Madanlal Choudhury v. Union of India<sup>10</sup> (2022)**, endorsing the relevance of FATF interpretations in construing the PMLA, further solidifies the integration of international norms into domestic law.

However, a significant regulatory gap persists. **Decentralized and non-custodial service providers**, which form a core part of the VDA ecosystem, largely remain outside the current regulatory scope. These entities, by their very design, challenge traditional oversight mechanisms, posing continued hurdles to transparency and enforcement. The future implications are profound: while the PMLA provides a powerful hammer, its effectiveness against the truly decentralized and anonymous segments of the crypto market is still to be fully tested. This ongoing evolution suggests that India's journey towards comprehensive crypto regulation will be incremental, characterized by continued adaptations and a constant re-evaluation of enforcement strategies.

Ultimately, the inclusion of VDAs under PMLA, while creating immediate challenges for unaware investors, is an undeniable step towards formalizing the crypto landscape in India. It initiates a crucial dialogue, pushing for much-needed regulatory answers to the surrounding ambiguities. But it also leaves us with a critical open question: **How will India reconcile its stringent anti-money laundering stance with the fundamental decentralized nature of cryptocurrencies, particularly as non-custodial and peer-to-peer interactions continue to proliferate, pushing the boundaries of traditional financial surveillance?** The balance between security and innovation, control and individual financial freedom, will define India's position in the global digital economy for years to come.

#### Citations

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