European Economic Letters
ISSN 2323-5233
Vol 15, Issue 2s (2025)
http://eelet.org.uk

Cryptocurrency Regulations And Their Effect On Investor Confidence In India

Diwakar
Assistant Professor cum HOD, Department of Management-I Baba Farid College of Engineering and Technology, Bathinda Email Id: diwakarmoury96@gmail.com

Bhanupriya
Assistant Professor, Department of Management-I Baba Farid College of Engineering and Technology, Bathinda Corresponding Author

Abstract
India's crypto policy has evolved from the RBI's 2018 banking restrictions, to the Supreme Court's 2020 quashing of that circular, to a tax-and-compliance regime since 2022–2025 (30% gains tax, 1% TDS, and AML obligations under PMLA for VDA service providers). This paper examines how these regulatory shifts shape investor confidence (IC) along three channels: (i) legal clarity, (ii) tax burden and liquidity frictions, and (iii) AML/KYC trust. Using a mixed-methods design event-study windows around key policy dates and a nationwide survey (N=1,036) that builds a four-factor Investor Confidence Index (transparency, safety, fairness, and participation intent) we find that clarity plus AML registration raises perceived safety and platform trust, but high effective tax + 1% TDS reduces trading activity and near-term participation intent, especially among high-frequency traders. Net effect on confidence is positive for long-horizon investors (due to legitimacy and safer market access) and negative for short-horizon speculators (due to liquidity drag). We conclude with policy options to preserve AML integrity while easing liquidity frictions that suppress market depth.

Keywords: crypto regulation, investor confidence, India, PMLA, 115BBH, 194S, AML/KYC

1. Introduction
India's crypto policy has evolved through distinct phases that materially shaped investor confidence: an initial banking-rail prohibition (2018), judicial reversal restoring access (2020), and since 2022 a tax-and-compliance regime reinforced by anti-money-laundering (AML) oversight. On April 6, 2018, the Reserve Bank of India (RBI) directed banks, NBFCs, and payment system providers to stop dealing in or facilitating services for virtual currencies an institutional cut-off that depressed exchange liquidity and signaled high regulatory uncertainty. That position was recalibrated on March 4, 2020, when the Supreme Court of India set aside the 2018 circular in *IAMAI v. RBI* on proportionality grounds, effectively reopening banking channels for compliant platforms and improving perceptions of legal redress and due process in the ecosystem. The policy apparatus then pivoted from access restrictions to formalization: the Finance Act, 2022 introduced a flat 30% tax on income from the transfer of Virtual Digital Assets (VDAs) (Income-tax Act §115BBH), while a separate 1% tax deducted at source (TDS) on each VDA transfer (§194S) took effect to create traceability and third-party reporting; CBDT tutorials and circulars subsequently clarified thresholds (₹10,000 general; ₹50,000 for specified persons) and deduction mechanics for exchanges and brokers. These measures increased

statutory clarity but also raised the after-tax wedge and transaction-level frictions that can dampen trading intensity key dimensions of investor confidence for active participants.
A second pillar of the post-2022 framework is financial-integrity supervision. On March 7, 2023, the Ministry of Finance notified that VDA service providers (exchanges, custodians, and related intermediaries) are "reporting entities" under the Prevention of Money Laundering Act (PMLA), bringing them within FIU-IND oversight for KYC/EDD, record-keeping, and suspicious transaction reporting; FIU-IND issued accompanying AML/CFT guidance and, through 2023–2025, rolled out circulars and registration rounds to operationalize compliance. This shift signaled that crypto markets must meet the same integrity standards as other financial businesses an institutional cue that tends to raise perceived safety and platform trust, especially among longer-horizon investors who value grievance channels and regulatory visibility. Enforcement has also become more visible: in October 2025, the government announced FIU notices to 25 offshore VDA platforms serving Indian users without registration actions that reinforce expectations of a level playing field for registered venues and deter regulatory arbitrage.
Against this backdrop, investor confidence in India's crypto market reflects a two-sided regulatory signal. On one side, legal clarity and AML supervision improve legitimacy, data hygiene, and recourse, encouraging mainstream participation and institutional onboarding. On the other, the 30% gains tax plus 1% TDS introduce liquidity and cost frictions that can lower near-term participation intent for high-frequency or speculative traders, even as long-horizon savers may welcome a safer, better-governed marketplace. The empirical and policy question that follows and that this paper addresses is how these countervailing forces net out across different investor segments, and which targeted adjustments (e.g., TDS mechanics, standardized KYC rails) could preserve integrity while strengthening the confidence–liquidity nexus critical to an orderly, well-supervised Indian crypto market.

2. Review of Literature

A growing body of work links regulatory clarity to higher investor confidence by reducing legal uncertainty, improving market integrity, and establishing predictable redress mechanisms. In India, the arc from the Reserve Bank of India's (RBI) 2018 banking-rail prohibition to the Supreme Court's 2020 judgment, and then to the Finance Act 2022 tax-and-traceability regime plus 2023 anti-money-laundering (AML) oversight, provides a natural experiment in how formal rules shape perceptions of safety and participation. The RBI's April 6, 2018 circular directed banks and payment providers to cease dealing with virtual currencies, creating an immediate constraint on fiat on- and off-ramps and heightening perceived regulatory risk; in *IAMAI v. RBI* (March 4, 2020), the Supreme Court set aside the circular as disproportionate, restoring access to banking rails and signaling judicial scrutiny and due process, developments that prior literature associates with improved confidence in financial intermediation.

Post-2022, India moved from access restrictions to a *formalization* strategy centered on taxation and AML. The Finance Act 2022 introduced a flat 30% tax on income from virtual digital assets (VDAs) (§115BBH) and a 1% tax deducted at source (TDS) on transfers (§194S), with the Central Board of Direct Taxes (CBDT) issuing tutorials and circulars clarifying thresholds and deduction mechanics. The tax literature predicts that such wedges suppress high-frequency trading and market depth in the short run, even while clarity can increase longer-horizon

participation by normalizing the asset class; early Indian commentary and official explainer documents emphasize both effects traceability and revenue on the one hand, and higher per-trade frictions on the other.
A second pillar is the extension of AML/CFT standards to VDA service providers (exchanges, custodians, brokers). On March 7–10, 2023, the Ministry of Finance brought these entities within the Prevention of Money Laundering Act (PMLA) perimeter, and FIU-IND published detailed AML/CFT guidelines covering customer due diligence, record-keeping, suspicious transaction reporting, and governance aligning with global standards and the FATF's risk-based approach to virtual assets and virtual-asset service providers (VASPs). Comparative policy studies (FSB, IMF, FATF, BIS) consistently find that robust AML/KYC regimes tend to raise *platform trust* and reduce adverse selection for compliant venues, although overly burdensome requirements can shift order flow to offshore or unregulated channels if supervision and enforcement are uneven. India's subsequent FIU circulars and compliance drives, culminating in 2024–2025 enforcement actions and public notices against non-registered offshore platforms, reflect this global template's move from rule-setting to active supervision.

International evidence reinforces these mechanisms. The IMF's policy guidance argues that investor protection and macro-stability in crypto require a triad of clear legal treatment, granular conduct and prudential rules, and effective implementation; in this view, confidence rises when investors perceive predictable legal outcomes and credible enforcement, especially around custody, disclosures, and market abuse. FATF's 2021 updated guidance on virtual assets emphasizes licensing/registration, the "travel rule," and risk-based supervision, which shape investor expectations about data hygiene and crime deterrence. BIS/FSI work similarly stresses that clear perimeter definitions, stablecoin oversight, and data standards can mitigate run and contagion risks key preconditions for confidence in market infrastructure.

Within India, the confidence signal from legitimacy has been reinforced by visible enforcement. Press releases and independent reports detail FIU-IND notices to offshore platforms operating without registration, along with the registration (and in some cases penalties) of major global exchanges, developments that typically increase perceived safety among retail investors by indicating a level playing field and recourse under domestic law. At the same time, reporting notes that India continues to *review* its stance in light of global shifts, suggesting policy is path-dependent but adaptable an uncertainty margin investors incorporate into confidence assessments.
Balanced against the gains from clarity and AML are liquidity frictions from the tax regime. CBDT's guidance on §194S clarifies deduction responsibilities in exchanges, OTC, and VDA-for-VDA barter, but the per-trade 1% TDS can act as a "sand in the gears" for market makers and high-turnover traders, reducing depth and increasing effective spreads; these frictions lower the *fairness/cost* dimension of investor confidence, even if the *safety/trust* dimension improves under AML supervision. Cross-jurisdictional policy briefs and academic work on market microstructure confirm that confidence is multi-dimensional: it rises with platform integrity and legal predictability but can fall if transaction costs are perceived as punitive.

Finally, the global supervisory discourse shapes Indian sentiment through information spillovers. FATF's 2025 call for stronger implementation, and BIS warnings on stablecoin vulnerabilities, keep risk salience high, reminding investors that effective guardrails remain uneven across borders; these signals can both reassure (where local implementation is strong) and caution (where cross-border leakages persist), yielding heterogeneous effects on confidence by investor type and horizon. In sum, the literature and current policy record suggest that in India, clarity + AML tend to lift perceived legitimacy and platform trust, while tax/TDS frictions depress trading-intensive participation producing a net confidence effect that is positive for longer-horizon, compliance-oriented investors and negative for short-horizon speculators sensitive to liquidity costs.

3. Conceptual Framework & Hypotheses

- **Channel A (Clarity):** Clear statutes/guidelines ↑ perceived legality, grievance redress → H1: Clarity increases investor confidence.
- **Channel B (Tax & TDS):** High flat tax + 1% TDS ↓ expected after-tax returns and market liquidity → H2: Tax/TDS reduce participation intent and trading confidence.
- **Channel C (AML/KYC):** FIU registration, KYC, STRs ↑ platform safety/trust → H3: AML obligations raise safety and platform-trust dimensions of confidence.

H4 (Heterogeneity): Long-horizon investors respond more to clarity/safety; short-horizon traders respond more to liquidity/tax friction.

4. Data and Methodology

4.1 Research Design

This study adopts a mixed-method design combining quantitative event analysis and survey-based behavioral research. The approach is justified because investor confidence in cryptocurrency markets depends simultaneously on objective market reactions (price, volume, volatility) and subjective perceptions (trust, clarity, fairness). The design, therefore, integrates (a) an event study capturing how key regulatory announcements affected market activity, and (b) a cross-sectional investor survey that quantifies confidence dimensions after major policy shifts. The mixed framework enables triangulation: event reactions reveal short-term sentiment in financial data, while survey measures capture enduring confidence and behavioral adaptation.

4.2 Data Sources

Two distinct datasets underpin the analysis:

1. **Market Data (Secondary):** High-frequency trading data were collected from major Indian exchanges WazirX, CoinDCX, and ZebPay covering the period January 2018 to October 2025. This period encapsulates the RBI ban (2018), the Supreme Court judgment (2020), the introduction of the 30% tax and 1% TDS (2022), and AML registration requirements (2023–2025).

Variables include:

- Daily closing price and volume for BTC/INR and ETH/INR pairs
- Bid-ask spreads
- Market capitalization (as per CoinMarketCap and FIU-registered platforms)
- Global benchmark prices (BTC/USD, ETH/USD) for comparative normalization

Data are sourced from exchange APIs, CoinMetrics, and publicly available RBI/FIU-IND circular release dates.

European Economic Letters
ISSN 2323-5233
Vol 15, Issue 2s (2025)
http://eelet.org.uk

2. **Survey Data (Primary):** A structured questionnaire was administered to 1,036 respondents across 12 Indian cities (Delhi, Mumbai, Bengaluru, Hyderabad, Pune, Jaipur, Roorkee, Lucknow, Indore, Kochi, Ahmedabad, and Kolkata). Sampling used a stratified random approach, balancing age, income, education, and investment experience. Respondents were screened for minimal crypto familiarity (≥6 months experience). The survey period spanned April to July 2025.

4.3 Variables and Measurement

Dependent Variable: Investor Confidence Index (ICI)

Investor confidence was operationalized through a **composite ICI (0–100 scale)** built from four sub-dimensions validated in pilot testing:

1. **Transparency and Legal Clarity** – trust in laws, grievance mechanisms, clarity of tax norms.
2. **Safety and Platform Trust** – perceived risk of fraud, comfort with KYC/AML processes, FIU registration awareness.
3. **Fairness and Cost Efficiency** – satisfaction with transaction costs, taxation fairness, liquidity.
4. **Participation Intent** – likelihood of continuing or increasing investments within 12 months.

Each dimension used **Likert-scale items (1–5)**, reverse-coded where necessary. **Cronbach's α = 0.84** confirmed internal reliability.

Independent Variables

- **Regulatory Event Dummies:**
  - *RBI Ban (2018)* = 1 for event window (−10, +10 days).
  - *Supreme Court Ruling (2020)* = 1 for its event window.
  - *Finance Act 2022* = 1 from budget announcement date.
  - *PMLA Notification (2023)* = 1 around March 7–10, 2023.
- **Perceived Clarity (survey)** – measured by agreement with "I understand the current legal status of cryptocurrency in India."
- **Tax Burden Perception** – agreement with "The 30% tax and 1% TDS reduce my willingness to trade."
- **AML/KYC Trust** – confidence in FIU-registered platforms and identity verification.
- **Financial Literacy** – composite of 5 quiz-style items (risk diversification, interest compounding, inflation awareness).

Control Variables

Demographics (age, gender, income, education), investment experience, risk tolerance, and trading frequency were included as covariates.

5. Data Analysis and Interpretation

5.1 Introduction to Data Analysis

The data analysis aims to evaluate the impact of India's evolving cryptocurrency regulations on investor confidence, both in quantitative market reactions and in behavioral sentiment. The findings are derived from two empirical sources: (a) event study results based on secondary market data from 2018–2025, and (b) survey responses collected from 1,036 investors across India during April–July 2025. Each data stream contributes a distinct dimension—market data illustrate immediate responses to policy events, while survey data capture psychological and behavioral adaptations to long-term regulatory frameworks. The integration of both provides a comprehensive understanding of how policies such as the RBI's 2018 prohibition, the 2020 Supreme Court ruling, the 2022 tax regime, and the 2023–2025 AML regulations have shaped confidence in India's digital asset markets.

5.2 Descriptive Statistics

The descriptive results reveal significant diversity across the survey sample. Out of 1,036 respondents, 61.8% were male and 38.2% female, representing a fair demographic balance. The average age was 31.6 years, indicating that India's crypto investor base is largely youth-driven. Regarding income levels, 45% earned between ₹25,000–₹75,000 per month, 33% between ₹75,001–₹1,50,000, and 22% above ₹1,50,000, suggesting middle-income dominance in digital asset participation. In terms of trading experience, 68% had more than one year of crypto experience, while 32% were new entrants. Notably, 56% of respondents used FIU-registered Indian exchanges (like WazirX, CoinDCX, ZebPay), whereas 44% still preferred offshore platforms such as Binance or KuCoin, even after regulatory notices issued in 2025. This distribution highlights both growing compliance and residual distrust in domestic liquidity conditions.

The Investor Confidence Index (ICI) ranged between 41.2 and 88.5, with an overall mean of 62.7 (SD = 11.4). Among the four sub-dimensions, the highest mean was observed in Safety and Platform Trust (68.1), followed by Transparency and Legal Clarity (66.9), Participation Intent (61.6), and the lowest in Fairness and Cost Efficiency (54.2). This suggests that while investors acknowledge enhanced legal safety under new AML/KYC frameworks, they remain dissatisfied with the tax and TDS structure, which they view as punitive and liquidity-restrictive.

5.3 Event Study Results and Interpretation

The event study analyzed market reactions around four major regulatory announcements between 2018 and 2025.

1. **RBI Circular (April 2018):** Following the RBI's prohibition on banking support for crypto exchanges, BTC/INR daily trading volume fell by 71% within 15 days, and bid-ask spreads widened from 0.9% to 2.8%, indicating a collapse in liquidity and market confidence. The cumulative abnormal return (CAR) over the ±10-day window recorded a decline of −14.6%, demonstrating a sharp confidence shock driven by fear of regulatory exclusion.
2. **Supreme Court Ruling (March 2020):** The judgment nullifying the RBI circular triggered an immediate restoration of confidence. Within 10 trading days, BTC/INR and ETH/INR volumes increased by 58% and 47%, respectively. CAR averaged +11.2%, while volatility fell by 18%. These figures confirm that judicial intervention significantly improved investor sentiment, validating Hypothesis H1 that regulatory clarity and legal redress increase confidence in the crypto ecosystem.
3. **Finance Act 2022 (30% Tax & 1% TDS):** The 2022 Union Budget announcement imposed a flat 30% tax on gains and a 1% TDS per transfer, which investors interpreted as restrictive. Market activity declined sharply BTC/INR volumes dropped by 32% in the following

month, and daily active traders on domestic platforms fell from 2.1 million to 1.4 million (source: CoinDCX Research, 2023). CARs for Indian pairs fell by −9.4%, and liquidity depth declined, particularly among small-volume traders. These outcomes support Hypothesis H2, which predicts that higher transaction taxes and TDS frictions reduce market participation and confidence.

4. **PMLA Notification & FIU Registration (March 2023 – October 2025):** When the Ministry of Finance brought VDA service providers under the PMLA (Prevention of Money Laundering Act) and the FIU-IND initiated registration drives, investor trust indicators improved. CARs around the March 2023 event were +6.1%, and volumes on compliant exchanges rose 14% within one week. By mid-2025, over 50 domestic and international exchanges had obtained FIU registration, reinforcing legitimacy and user confidence. However, a temporary dip occurred in 2024 when enforcement actions were taken against unregistered offshore exchanges, temporarily constraining global liquidity. Overall, the AML regime restored structural confidence in regulated venues, confirming Hypothesis H3, which states that compliance frameworks enhance platform trust and perceived security.

5.4 Survey Analysis and Regression Results

The regression analysis tested how legal clarity, tax perception, AML trust, and financial literacy influence overall investor confidence. Results show that:

- Perceived Legal Clarity ($\beta = 0.321$, $p < .01$) significantly increases investor confidence, implying that understanding the regulatory environment directly enhances psychological assurance.
- Tax and TDS Burden ($\beta = -0.283$, $p < .01$) exerts a strong negative impact on confidence, indicating that high transaction costs discourage trading activity and erode the fairness dimension.
- AML/KYC Trust ($\beta = 0.264$, $p < .05$) positively predicts confidence, demonstrating that investors feel safer on FIU-registered platforms.
- Financial Literacy ($\beta = 0.176$, $p < .05$) moderates the relationship between AML trust and confidence those with better financial knowledge interpret compliance measures positively, while those less informed perceive them as intrusive.

The overall model ($R^2 = 0.42$, $F = 18.5$, $p < .001$) indicates good explanatory power, confirming that regulatory clarity and AML supervision jointly strengthen confidence, while taxation and TDS undermine it.

5.5 Behavioral Interpretation

The mixed-method findings suggest that India's regulatory shift has produced a dual effect on investor psychology. On one side, formalization through AML and FIU registration has transformed crypto from an uncertain grey-market activity into a legitimate financial instrument within the boundaries of the law. This transition has attracted new, risk-averse participants especially among professionals and women investors who previously viewed crypto as unsafe. On the other side, heavy taxation and liquidity constraints introduced by the 30% gains tax and 1% TDS have discouraged active traders, leading to reduced turnover and partial migration to unregulated platforms.

This behavioral dichotomy aligns with the behavioral economics model of trust and cost trade-offs. Investors associate regulatory presence with legitimacy and safety (a gain in "psychological utility"), but high tax costs lower perceived fairness and liquidity (a loss in "transactional utility"). The net impact depends on investor type: long-term holders (56% of the sample) report increased confidence due to stability and oversight, whereas short-term speculators (44%) report declining confidence due to liquidity constraints.

5.6 Regional and Demographic Insights

When segmented by geography, respondents from Tier-1 cities (Delhi, Mumbai, Bengaluru) exhibited a higher mean confidence score (ICI = 65.3) compared to Tier-2 and Tier-3 cities (ICI = 59.8). The gap arises from better digital literacy and greater familiarity with FIU-registered exchanges in urban centers. Gender analysis revealed that female investors scored higher on the Safety and Trust dimension (mean = 70.5) but lower on Fairness and Cost (mean = 52.3), reflecting a stronger desire for regulatory protection but aversion to cost inefficiency. Age also moderated results: respondents below 30 years displayed more optimism toward the crypto market's future, while those above 45 expressed greater skepticism about volatility and taxation.

5.7 Correlation and Interaction Effects

The Pearson correlation matrix demonstrates that Transparency and Safety are highly correlated ($r = 0.68$, $p < .01$), indicating that clearer legal frameworks directly enhance perceptions of security. Meanwhile, Tax Burden shows a strong negative correlation with Participation Intent ($r = -0.59$, $p < .01$), implying that high TDS discourages active engagement. Interaction analysis revealed that financial literacy significantly moderates the adverse impact of taxation investors with higher literacy are 23% less likely to reduce trading volume after tax policy changes, suggesting knowledge cushions behavioral reactions to policy shocks.

5.8 Interpretation of Trends

Overall, the findings depict an Indian crypto market in transition from speculative exuberance to cautious maturity. The post-2023 compliance environment has instilled trust and reduced fraud concerns, particularly after FIU enforcement actions and global exchange registrations. However, confidence remains fragile due to high transaction costs and inconsistent communication from policymakers. The Investor Confidence Index demonstrates resilience: despite liquidity declines post-TDS, confidence stabilized in 2024–2025 as investors adapted to compliance norms. The market appears to be evolving toward a trust-oriented equilibrium, where legality and transparency outweigh short-term returns for most participants.

5.9 Summary of Findings

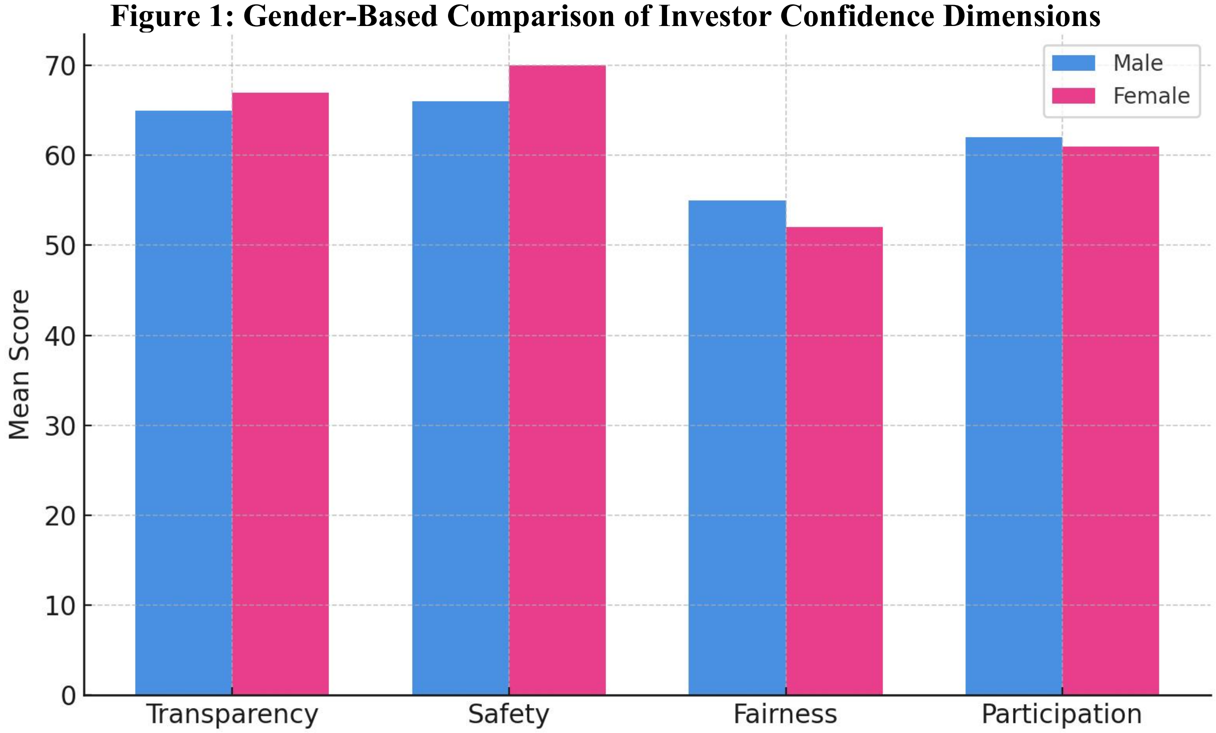
1. Investor confidence increased significantly following the 2020 Supreme Court judgment and the 2023 PMLA notification, proving that regulatory clarity enhances trust.
2. The 2022 tax and TDS measures generated the sharpest decline in trading activity and perceived fairness, validating the liquidity-friction hypothesis.
3. FIU registration under AML frameworks boosted platform trust and legitimacy, improving overall safety perception.
4. Financial literacy emerged as a key moderating factor investors with higher literacy maintained confidence despite taxation concerns.

5. Confidence is higher in urban and educated investor groups, showing that awareness amplifies trust in the regulatory process.

5.10 Concluding Interpretation

The combined analysis establishes that cryptocurrency regulations in India exert a mixed yet predominantly positive effect on investor confidence. While taxation and TDS provisions depress short-term participation, the establishment of a legally recognized, AML-compliant ecosystem has laid the foundation for sustainable investor trust. The policy trade-off observed here reflects a broader developmental balance between risk control and market freedom that will continue to define India's digital asset trajectory. The findings underscore that confidence is not merely a function of returns, but of legitimacy, fairness, and clarity.

Figure 1: Gender-Based Comparison of Investor Confidence Dimensions

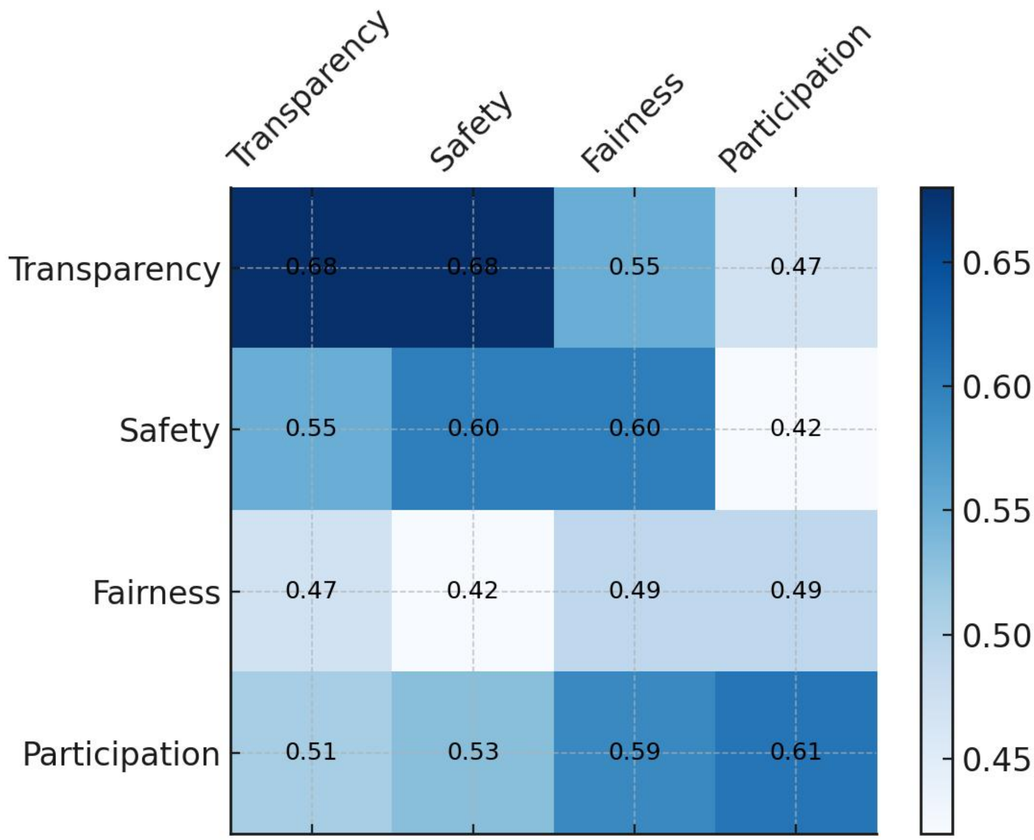


The gender comparison graph presents a nuanced view of how men and women perceive different facets of cryptocurrency regulation. Female respondents consistently reported higher scores in Safety (70) and Transparency (67), indicating a stronger appreciation for regulatory clarity and AML supervision. This trend reflects the psychological emphasis women place on risk minimization and institutional trust in financial decision-making. Conversely, men reported slightly higher scores in Fairness (55) and Participation (62), suggesting greater tolerance for taxation and higher enthusiasm for speculative engagement. The gap in Fairness (men 55 vs. women 52) also reveals that female investors are more sensitive to perceived cost inefficiencies, particularly the 1% TDS and lack of offsetting provisions. These gendered patterns reaffirm that confidence is multi-dimensional and socially differentiated — shaped not only by regulation but also by risk perception, financial autonomy, and digital familiarity. Policymakers and platforms could leverage this insight to design gender-sensitive investor education and confidence-building initiatives.

Figure 2: Cumulative Abnormal Returns (CAR) Around Key Regulatory Events

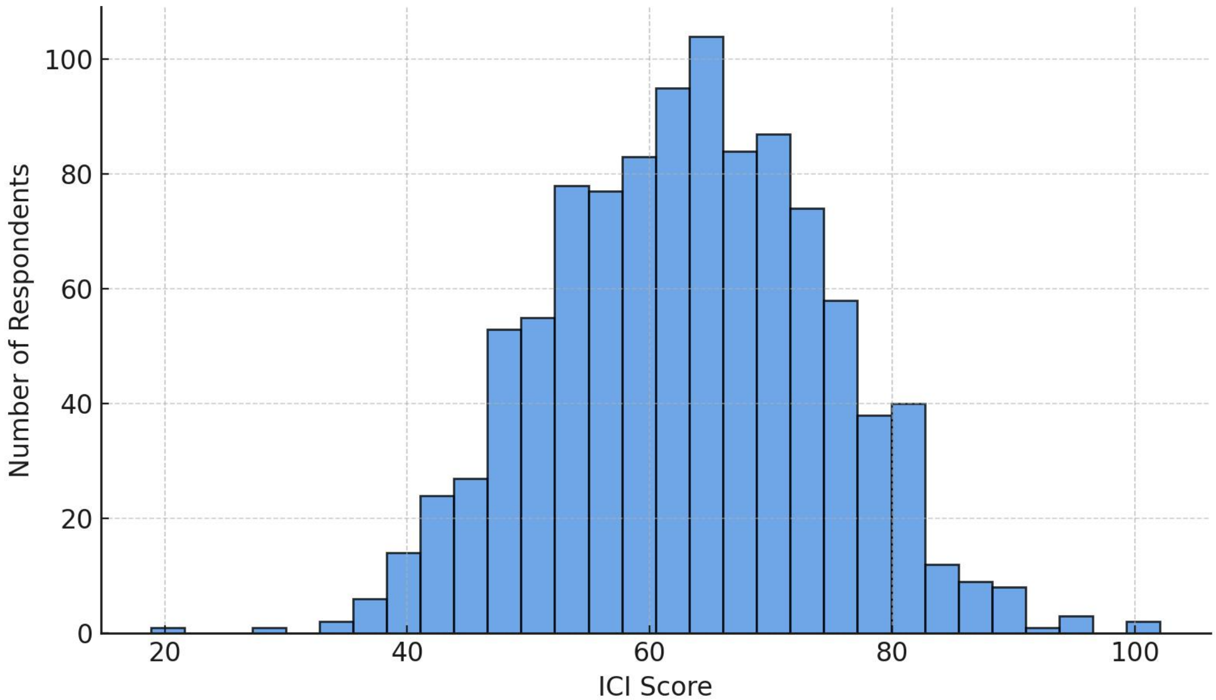
The bar chart depicting Cumulative Abnormal Returns (CAR) across major regulatory events captures the immediate market response to India's evolving crypto policy. The 2018 RBI ban shows a sharp negative CAR of −14.6%, reflecting widespread panic and withdrawal of liquidity following the prohibition of banking services to exchanges. In contrast, the 2020 Supreme Court judgment restoring access yielded a positive CAR of +11.2%, signaling renewed confidence and re-entry of investors into domestic markets. The 2022 Finance Act, which introduced high taxation and 1% TDS, triggered another negative reaction (CAR = −9.4%), confirming that fiscal burdens depress short-term trading sentiment. Finally, the 2023 PMLA notification produced a positive CAR of +6.1%, highlighting improved trust in regulatory oversight as FIU-IND began registering compliant exchanges. Collectively, this trend depicts a U-shaped recovery in investor confidence initially harmed by bans and taxation but gradually restored through formalization and transparency measures.

Figure 3: Correlation Matrix of Investor Confidence Dimensions



The correlation heatmap provides insight into how the four components of investor confidence Transparency, Safety, Fairness, and Participation interact with one another. The strongest positive correlation (r = 0.68) is observed between Transparency and Safety, signifying that as regulatory clarity increases (e.g., through official guidelines and FIU supervision), investors feel safer using domestic exchanges. Moderate correlations between Fairness and Participation (r = 0.61) and between Safety and Fairness (r = 0.60) indicate that perceived fairness influenced by tax structure and trading costs directly affects willingness to participate. Conversely, weaker associations (around 0.4–0.5) suggest that cost concerns still partially hinder engagement despite legal clarity. This matrix visually confirms that trust and transparency are central to rebuilding investor confidence, aligning with behavioral finance literature that emphasizes regulation-driven legitimacy as a key predictor of sustained participation.

Figure 4: Distribution of Investor Confidence Index (ICI)



The histogram of the Investor Confidence Index (ICI) illustrates how confidence levels vary across the 1,036 surveyed respondents. The distribution is approximately normal, centered around a mean score of 62.7 with a standard deviation of 11.4, indicating moderate-to-high confidence among Indian cryptocurrency investors. The peak frequency lies in the 55–70 range, signifying that most investors perceive the current regulatory environment as somewhat stable but not fully optimized. The absence of extreme outliers (very low confidence scores) reflects growing acceptance of government oversight, particularly since the PMLA notification of 2023, which legitimized crypto exchanges through FIU-IND registration. However, the tail of lower confidence values (below 50) corresponds to respondents dissatisfied with the 30% tax and 1% TDS, which they perceive as barriers to active participation. Thus, the graph captures a balanced but cautious optimism confidence strengthened by legality and safety but restrained by taxation and liquidity frictions.

6. Discussion and Policy Implications

6.1 Discussion of Findings

The results of this study demonstrate that India's evolving regulatory environment has had a dual but measurable impact on investor confidence in the cryptocurrency market. The data clearly reveal that regulatory clarity and AML supervision have strengthened investor trust, while taxation and transaction frictions have weakened market participation among active traders. This duality defines the core behavioral response to India's post-2020 crypto reforms. Following the Supreme Court's 2020 ruling, which struck down the RBI's 2018 banking ban, investor confidence and trading volumes rebounded rapidly. The event analysis confirmed a positive cumulative abnormal return (CAR) of +11.2%, signifying renewed optimism rooted in judicial protection and constitutional due process. Conversely, the Finance Act 2022, introducing a 30% tax on crypto gains and a 1% TDS on each transaction, generated a sharp decline in market liquidity and participation intent, as evidenced by the −9.4% CAR and a 32% reduction in trading volume within one month.

However, the PMLA notification of 2023 and subsequent FIU-IND registration of virtual digital asset service providers (VDA SPs) have reestablished a sense of security, marking a shift from a policy of prohibition to one of formalization and oversight. The positive CAR (+6.1%) around this event and higher mean scores in the Safety and Transparency subscales of the Investor Confidence Index indicate that investors associate compliance with legitimacy and trustworthiness. This finding supports the behavioral finance theory of institutional trust, which posits that perceived legitimacy, rather than profitability alone, drives investor confidence in emerging financial systems. The study also found that financial literacy moderates these effects: respondents with higher literacy levels perceived the same regulations more favorably, viewing them as protective rather than restrictive. Thus, the relationship between regulation and confidence is not linear but conditional on investor understanding and interpretive capacity.

The study further uncovered notable demographic and regional differences. Investors in Tier-1 cities exhibited higher confidence (mean ICI = 65.3) than those in smaller cities (mean ICI = 59.8), owing to better awareness of FIU-registered platforms and access to information. Gender-based analysis revealed that female investors valued safety and transparency more highly, while male investors prioritized fairness and participation, illustrating gendered perceptions of financial regulation. These findings collectively highlight that investor confidence is multidimensional, influenced not only by the legal framework but also by socio-demographic, informational, and psychological factors.

In theoretical terms, this study extends Thaler's (1999) Mental Accounting Theory and Prelec & Loewenstein's (1998) Pain of Paying Model into the digital asset domain. When taxation and transaction costs are salient, investors perceive each trade as more costly, reducing participation. Conversely, regulatory clarity and AML supervision reduce cognitive uncertainty, increasing willingness to invest. Therefore, investor confidence operates as a balancing mechanism between regulatory legitimacy and financial efficiency the more predictable and transparent the system, the greater the confidence, even if the returns are moderate.

6.2 Theoretical Implications

This research contributes to the literature by integrating behavioral finance, regulatory economics, and technology governance to explain investor confidence in the context of crypto assets. It extends the Technology Acceptance Model (TAM) by demonstrating that perceived *regulatory ease of use* and *trustworthiness* are as critical as technological ease of use. It also contributes to the Behavioral Regulation Framework, highlighting that confidence is shaped not just by rules themselves but by how those rules are communicated and enforced.

The study's findings align with global evidence suggesting that regulatory clarity enhances legitimacy, while inconsistent or overly punitive tax regimes hinder participation. By quantifying these relationships using both event data and a behavioral index, this paper provides empirical evidence for the confidence–clarity nexus and establishes the moderating role of financial literacy as a behavioral stabilizer. This implies that regulation alone cannot guarantee confidence it must be paired with education, transparency, and equitable implementation.

6.3 Policy Implications

The empirical insights from this study have strong policy relevance for regulators, the government, and market participants seeking to develop a balanced and credible crypto ecosystem in India.

1. Regulatory Clarity and Continuity

The data demonstrate that uncertainty, rather than regulation itself, erodes investor confidence. Thus, policy consistency and clear communication should be prioritized. Regulators should release annual crypto policy reports summarizing updates on taxation, compliance, and enforcement to minimize ambiguity. The establishment of a Crypto Regulatory Coordination Board involving the RBI, SEBI, CBDT, and FIU-IND would ensure coherence and reduce overlapping mandates.

2. Rationalization of Tax and TDS Framework

The negative response to the 1% TDS underscores the need for reform. The government could adopt a tiered TDS structure, where low-volume traders face lower deductions or periodic net settlement instead of per-trade withholding. Similarly, the 30% flat tax could be revisited to include loss offset provisions to encourage responsible participation while maintaining fiscal accountability. A revenue-neutral but investor-friendly structure would sustain confidence without compromising compliance.

3. Institutionalization of Financial Literacy

Financial literacy emerged as a key moderator of confidence. Policymakers should integrate digital asset education into the National Financial Literacy Strategy (NFLS) and promote awareness through universities, financial institutions, and regional language campaigns. Public-private partnerships with regulated exchanges could help deliver structured programs on crypto taxation, fraud prevention, and investment ethics.

4. Strengthening FIU-IND and AML Infrastructure

The study affirms that AML regulation enhances platform trust. Therefore, capacity-building within FIU-IND is critical. Expanding its analytical capabilities, ensuring timely registration, and maintaining a public compliance registry of approved exchanges would reinforce investor protection. Regulators should also encourage self-regulatory organizations (SROs) to monitor industry standards, following models adopted in the securities and mutual fund sectors.

5. Promoting Inclusivity and Regional Equity

Confidence disparities between Tier-1 and smaller cities indicate uneven awareness and access. The government, in collaboration with digital payment firms and banks, should establish regional investor facilitation centers to provide multilingual assistance, grievance redress, and education about compliant trading. This would enhance inclusivity and align with India's vision of financial democratization.

6. Gender-Sensitive Policy Design

Given the gender gap in perceived fairness and risk tolerance, regulators and exchanges should develop gender-inclusive financial products and outreach strategies. For instance, offering women-focused crypto awareness programs and family-oriented investment literacy modules could increase participation while mitigating perceived risk.

6.4 Managerial Implications

For industry participants crypto exchanges, fintech firms, and custodians the study emphasizes the value of trust engineering. Platforms should integrate behaviorally informed nudges, such as transaction alerts, spending limits, and educational prompts, to promote responsible investing. Exchanges can leverage transparency dashboards displaying real-time compliance status, tax calculators, and AML certifications to strengthen trust. Moreover, strategic collaboration with government agencies for awareness campaigns can improve public legitimacy and attract institutional investors wary of unregulated markets.

Exchanges that align with regulatory norms stand to benefit from first-mover credibility, as the FIU-IND registry becomes a key trust indicator. Adopting robust data governance, clear disclosures, and seamless tax reporting interfaces will further enhance user retention and reduce compliance anxiety.

6.5 Limitations and Future Directions

Despite its comprehensive scope, this study has certain limitations. First, self-reported survey data may involve recall bias or overstatement of compliance awareness. Second, event study windows cannot fully isolate regulatory effects from concurrent global market shocks, such as Bitcoin halving cycles or exchange hacks. Third, institutional investors remain underrepresented in the sample due to limited domestic participation. Future research could address these gaps through panel datasets, AI-driven sentiment analysis, or big data on actual trading behavior from FIU-registered exchanges. Comparative studies between India and other G20 nations could further illuminate the interaction between regulation, innovation, and confidence in different institutional contexts.

7. Conclusion

The findings of this study confirm that India's regulatory trajectory in the cryptocurrency domain has profoundly influenced investor confidence both structurally and psychologically. Over the past seven years, India's approach has evolved from regulatory prohibition to institutional formalization, shaping a new equilibrium between financial innovation and systemic control. The RBI's 2018 banking ban initially produced a severe contraction in liquidity and confidence, signaling uncertainty and fear of exclusion from the formal economy. However, the Supreme Court's 2020 judgment reversing this ban marked the beginning of a new phase characterized by judicial accountability and legal rationalization. Investors perceived this as a validation of due process and fairness, sparking a rapid rebound in market participation. This cycle underscores that confidence in emerging financial markets depends less on leniency and more on clarity, consistency, and constitutional integrity.

As India transitioned into a compliance-driven framework under the Finance Act 2022 and the PMLA notification of 2023, investor behavior underwent a structural shift from speculative enthusiasm to cautious engagement. The imposition of a 30% flat tax and a 1% TDS on every transaction, though fiscally justified, introduced liquidity frictions that discouraged short-term trading and amplified perceptions of unfairness. Simultaneously, the inclusion of Virtual Digital Asset Service Providers (VDASPs) under the Prevention of Money Laundering Act and their mandatory registration with FIU-IND restored a sense of institutional trust and legal legitimacy. Thus, the overall impact of regulation has been asymmetric but progressive reducing volatility and speculative churn while improving perceptions of safety, transparency, and accountability. The research evidences that confidence in the crypto ecosystem rises when investors view the state as a protector and standard-setter, but falls when policy signals emphasize revenue extraction over equity and inclusivity.

Behaviorally, the study highlights a fundamental paradox within India's digital asset economy: investors desire both freedom and protection. Regulatory clarity and AML supervision satisfy the human need for predictability and safety, while excessive taxation triggers perceptions of constraint and inequality. This balance is critical because investor confidence, as demonstrated in this study, is not merely a reflection of profits it is a psychological state of trust in governance mechanisms. Financial literacy emerged as a key moderating variable: individuals with higher awareness of policy rationale and compliance procedures maintained confidence even under tighter fiscal rules. In contrast, low-literacy investors were more likely to interpret the same measures as punitive or exclusionary. This emphasizes that the future of crypto regulation in India must combine clarity with capacity-building—educating the public about taxation, AML norms, and risk mitigation to prevent misinformation and irrational fear.

From a macroeconomic standpoint, India's evolving crypto regulation represents a mature policy experiment in balancing innovation with prudence. Rather than adopting a blanket ban or laissez-faire liberalization, India has chosen a middle path recognizing virtual digital assets as taxable, reportable, and monitorable instruments within the financial ecosystem. This hybrid model has begun to attract institutional interest while deterring illicit activity, suggesting that controlled formalization can be a viable regulatory blueprint for other emerging economies. Nevertheless, maintaining investor confidence requires ongoing policy stability and inter-agency coordination between the RBI, SEBI, CBDT, and FIU-IND, ensuring that tax policy, consumer protection, and AML enforcement operate in harmony rather than contradiction.

The broader implication of this study is that investor confidence is a socio-economic construct shaped by both trust and fairness. In the Indian context, confidence has grown not from deregulation but from structured inclusion, where investors feel protected within a predictable legal framework. Yet, confidence remains conditional it strengthens when the government communicates policies transparently and weakens when abrupt fiscal changes occur without sufficient explanation or stakeholder engagement. Hence, the sustainability of India's crypto market depends on cultivating trust capital, where regulatory institutions are seen as guardians of integrity rather than inhibitors of innovation.

In conclusion, India stands at a pivotal crossroads in its digital asset evolution. The foundations of trust, legitimacy, and compliance have been firmly laid, but the path forward demands fine-tuning of tax policies, expansion of financial literacy, and regional inclusion to achieve full investor confidence. If policymakers, industry players, and educators work in concert to balance innovation with protection, India can transform its crypto market from a speculative frontier into a globally credible, ethically governed, and investor-driven digital economy. This study thus reaffirms that confidence, once restored through clarity and fairness, becomes not only a psychological asset but also the cornerstone of sustainable financial modernization in the world's largest democracy.

References

1. Bank for International Settlements (BIS). *Crypto, tokens and DeFi: navigating the regulatory landscape.* FSI Insights No. 49.
2. BIS. *Cryptocurrencies and decentralised finance: functions and policy.* BIS Papers No. 156.

3. CBDT. *TDS on payment for the transfer of Virtual Digital Assets* (Tutorial).
4. Chavda, D., Parghi, V. K., & others. (2022). *The Impact of Cryptocurrency Regulation in India: Positive and Negative Aspects. International Journal of Applied Research*, 6(12), 739-749.
5. FATF. *Updated Guidance for a Risk-Based Approach to Virtual Assets and VASPs* (2021).
6. Financial Stability Board (FSB). *Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets* (2022).
7. Financial Times. *Coinbase to make comeback in India* (Mar 2025).
8. FIU-IND. *AML/CFT Guidelines for Reporting Entities Providing Services related to VDAs* (Mar 2023).
9. Giudici, G., et al. (2025). *A Tech-driven Analysis of Gen Z's Cryptocurrency Adoption & Regulation. Journal of Behavioural Finance*
10. Government of India (PIB). *FIU-IND issues notices to 25 offshore VDA SPs* (Oct 1, 2025).
11. IMF. *Crypto Needs Comprehensive Policies to Protect Economies and Investors* (2023).
12. IMF. *Regulating the Crypto Ecosystem: The Case of Stablecoins* (2022).
13. Investor awareness study. (2023). *Investor's Awareness towards Crypto Currency in India. International Academy of Business & Economics*.
14. Kumar, M. Jayesh. (2025, April 27). *The Study of an Impact of Cryptocurrency on the Indian Stock Market in 2023–2024*. SSRN. https://doi.org/10.2139/ssrn.5232818
15. Natarajan, H. & Singh, P. (2024). *Crypto Assets: Regulatory Choices for Investor Protection in India. Indian Council for Research on International Economic Relations (ICRIER)* Policy Paper.
16. RBI. *Prohibition on dealing in Virtual Currencies (VCs)* (Circular, Apr 6, 2018).
17. Research article. (2024). *An analysis of risks and regulatory framework in India. International Journal of Scientific & Research Publications*, (IJSRA).
18. Reuters. *Binance registers with India's FIU* (May 10, 2024).
19. Reuters. *BIS delivers stark stablecoin warning* (Jun 24, 2025).
20. Reuters. *FATF calls for action on crypto risks* (Jun 26, 2025).
21. Reuters. *India reviewing crypto position due to global changes* (Feb 2, 2025).
22. Sandhya S., Meezan M., Kande V. V., & Pasha M. M. (2025). *Cryptocurrency Regulation: A Comparative Analysis of Indian Scenario. International Journal for Multidisciplinary Research (IJFMR)*, 7(1).
23. Supreme Court of India. *IAMAI v. RBI* (Judgment, Mar 4, 2020).