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# Regulation of Bitcoin within the European Union

Master Thesis

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The story of Bitcoin is marked by excitement, controversy, hope and greed. Since its inauguration in 2009, Bitcoin has managed to gain a large popularity around the globe (Bahgla, 2017). Bitcoin is a decentralized Currency, which does not require any third party such as a Reserve Bank to be involved, therefore the framework of traditional payment systems cannot be considered (Shcherbak, 2014, p. 50). Several legal bodies of the European Union have discussed the need of regulating decentralized Cryptocurrencies and carrying out risk assessments on the potential threats of decentralized cryptocurrencies (Guadamuz & Marsden, 2015). Currently, there is no joint international approach to regulate Bitcoin resulting in varying legal status´ globally. In Japan for instance, the government considers Bitcoin as a legal form of tender whereas, China has banned the use of Bitcoin (Norry, 2018, p.1).

The inauguration of Bitcoin in 2009 has made it possible for criminals to extend their illicit activities. Since the anonymity feature of Bitcoin guarantees that transactions are not easy to trace, criminal organizations acknowledge Bitcoin as a safe haven for criminal activities (Pinter, 2013, p. 11). In addition to the anonymity feature, the cross-border nature of crypto markets and crypto players is a key challenge for legal authorities. The major issue is that some crypto markets and crypto players are located in countries with insufficient legislation for money laundering, terrorist financing and tax avoidance.

The European Union implemented the fifth anti-money laundering directive in 2018, which marked a key development in the recognition of cryptocurrencies in the European Union. More specifically, the AMLD5 labels exchange platforms and custodian wallet providers as ‘obliged entities’ under article 2.1 of the Directive. In addition, custodian wallet providers have to be registered to the local authorities, carry out an identity check of their customers and report suspicious activities (Dehio, n.D.). The EU member states have to implement AMLD5 into their national law by 2020 (Directive EU 2018/843, 2018).

The most interesting aspect for tax authorities and Bitcoin users is undoubtedly the tax benefits of investing and trading in Bitcoin (Bal, 2015, p. 267). Bitcoin and other decentralized cryptocurrencies can generate income tax and consumption tax. Bitcoin is not legally considered as money however that does not restrict the taxation of Bitcoin (Bal, 2013, p. 354).

Various countries have banned or stringently restricted the use of Bitcoin for consumers and businesses. These countries assume that there no need for decentralized cryptocurrencies. The main purpose of a national wide ban is usually to prevent money laundering, tax evasion and terrorist financing. A side effect of this approach is that businesses and consumers of Bitcoin are not covered under the law. Therefore, more effective regulations approaches have to be developed. Currently most countries, including the EU, are in the ‘wait-and-see’ mode. The reason for this approach is observe how other governments implement Bitcoin into their national legislation, how effective it is and how cryptocurrencies develop in general (Ramasastry, 2014). Nevertheless, most countries have already enforced tax regulations on Bitcoin transactions and holdings. For instance, the EU treats Bitcoin as a speculative asset to which capital gains tax is relevant (Perkins coie, 2018). Germany has a powerful consumer and investment market and therefore it has chosen a progressive approach towards Bitcoin. Germany is the first country to endorse Bitcoin as a private money. The German Ministry of Finance declared in a statement in 2013 that they will recognize Bitcoin as a ‘unit of account’. This decision does not give Bitcoin the level of legitimacy, but it allows it use in private transactions (Arthur, 2013).

The global growth and outreach of cryptocurrencies requires an international approach and consistency. National legislation of the Bitcoin ecosystem might be inefficient, because stakeholders can easily choose the best location to do their business and escape liability (Pollock, 2018; Canepa, 2018). Bitcoin is global, easily accessible and innovative. Legal authorities who establish legislation must find the right balance between the protection of the stakeholders and the benefits of cryptocurrencies. Therefore, the Bitcoin regulation must be neutral and flexible to adapt to the future benefits of the technology (Dash, 2019, p. 1). Another major risk to Bitcoin users is the absence of legal support in the Bitcoin ecosystem. Regulations, which establish the implementation of reporting standards such as anti-money laundering do not safe Bitcoin user´s funds (Bonney, 2013).

The EU has taken a resolute approach towards the Regulation of Bitcoin. The implementation of the AMLD5 has established a regulatory regime which addresses the illicit use of Cryptocurrencies against money laundering and financing terrorism. However, the scope of the Directive does not include all exchange platforms. The EU has to extend the scope of the Directive to fight money laundering and tax evasion effectively. The extension of the scope can be realized by implementing a broader definition of exchange platforms that covers all potential uses that can proceed through exchange platforms. By setting the intermediaries as a gatekeeper, the anonymity feature of Cryptocurrencies will be eliminated, simply because money laundering regulations force exchange platforms to implement KYC policies. In addition, the regulation approaches worldwide and in the European Union are highly diversified because each country is confronted with different sort of risks. Due to its unique features the Bitcoin ecosystem requires a harmonized approach with a powerful global coordination in order to implement consistent regulation. This can help to combat launderers who are interacting in countries without any administrative policies on cryptocurrencies for money laundering, so they can cash out the profits of crime and place it in the legal financial system. Moreover, the implementation of such policies can increase the trust within the Crypto-market, gain users and support the protection of consumers and businesses.

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