Cryptocurrencies Bitcoin & co – new applications and regulatory challenges

Arthur Stadler, Brandl & Talos Attorneys at Law, Vienna
Gaming regulators in jurisdictions such as Malta or the Isle of Man continue to assess whether or not to allow digital currencies in a gaming environment, in particular within the licensed offer under their respective gaming legislation. In June 2014, the Isle of Man announced being “digital currency friendly” and put amendments of its Gaming legislation in place. At the same time, the Isle of Man increased measures in order to protect players and combat crime.

Before going into detail concerning the vast applications of digital currencies, the term “Bitcoin” and the understanding of “digital currency” shall be defined for the sake of consistency within this article: Firstly, by using these terms we understand an alternative monetary system being a possible substitution and the opposite of traditional “money” that is emitted and controlled by national (central) banks. Secondly, by the terms “Bitcoin / digital currency” we understand the peer-to-peer-system and its very specific technology of “block chains”. And thirdly, inherent to the block chain system we understand these terms to define a Network Protocol that – for first time in history – allows the “programmability” of money.

The block chain technology behind the Network Protocol also allows automated contracts (so called “Smart Contracts”), e.g. allowing a customer to instantly access a leased car literally one second after paying via bitcoin, or online access to music, movies or software as soon as the virtual money flows, while the contract (and with it the enjoyment of the pur-chased services) stops as soon as the payment is lacking. A number of gaming companies have already set up exchange platforms, through which they convert traditional currency into digital currency and vice versa. Several games, such as the best-selling PC game Minecraft or the gaming experiment Bitquest, already accept the cryptocurrency Bitcoin, appreciating its core characteristics of extremely cheap and fast transactions combined with the ability of programming micropayments e.g. for entering certain levels, acquiring items to mitigate the damage from “monster attacks” or purchasing in-game tools, such as interactive weapons, armour or food.

Back to allowing alternative “money” in a gaming environment, the most evident and essential regulatory requirements to follow are putting in place appropriate KYC tools as well as AML/anti-terrorism-funding controls. National regulators and legislators seem to be rather overwhelmed by the developments in the sector of cryptocurrencies and are calling for more regulation, similar to what was the case at the beginning of the rise of online gaming more than a decade ago. However, after appreciating how beneficial this new technology of Bitcoin transactions and in-game micropayments can be, labelling Bitcoin as illegal activity does not seem to be the right way of dealing with this new phenomenon. Experience with online gaming, social gaming and now cryptocurrencies shows that regulators do not need to “reinvent the wheel” and to call for brand new regulation and legislation; it is rather the application of already existing rules for AML/KYC, which might be quite burdensome in some areas, but will lead the way, applied in the appropriate manner for micropayments: this includes KYC process, ID checks, suspicious activity reporting, etc as already included in AML legislation at national level.

Considering that today around 80% of the world’s Bitcoin transactions are gaming-related, the rules to apply are well known to operators. The challenge for regulators and operators alike is rather the speed of transactions and consumer demand. The benefit for operators and (long term) also for regulators is – again – an attractive and successful offer for customers in order to remain with the licensed offer: the benefit of the cheapest processing, no charge-backs from payment providers and the growing acceptance of cryptocurrency in other, non-gaming sectors speak a clear language. Furthermore, payment providers such as PayPal recently announced a mechanism for merchants to accept Bitcoin, while Microsoft accepts Bitcoin for in-game purchases, which might move cryptocurrencies forward even quicker than expected.
At EU-level, the European Central Bank, similar to the Bank of England and the US Federal Reserve, issued reports that cryptocurrencies, such as Bitcoin, will be at least monitored but are currently not considered to be harming the supply of (traditional) money. The EU Banking Authority, however, has warned banks not to engage in any cryptocurrency transactions until regulators can protect both types of currencies. The EU Banking Authority's fear is that the trading platforms of digital currencies could be hacked.

To illustrate how regulators are currently assessing Bitcoin as Europe's most widely used digital currency and how regulators are seemingly embedding the Bitcoin phenomenon into the existing legal framework for financial services, we want to outline below how the Austrian Financial Market Authority (FMA) is currently scrutinizing Bitcoin under the Austrian financial services regulations. For the purpose of this article, there are two services of relevance for the gaming companies, namely (a) bitcoin exchange services and (b) bitcoin tools for merchants accepting bitcoins. The Austrian FMA posted on its website on 19 March 2014: “Bitcoin is a virtual currency that is neither regulated nor supervised by the FMA” (available online at http://www.fma.gv.at/en/special-topics/bitcoin.html). However, the FMA also stated that certain “business models based around Bitcoin may require compulsory licensing in accordance with statutory provisions, the enforcement of which falls within the remit of the FMA,” without further specifying this statement. At the same time, the FMA is currently scrutinizing Bitcoin under the Austrian financial services regulations.

In the absence of relevant case-law and decisions yet issued by the FMA, we are of the opinion that (a) mere exchange services and (b) tools for accepting Bitcoin for online services do not meet the requirements of being considered subject to the Austrian Payment Services Act (“Zahlungsdienstegesetz”) implementing the EU Payment Services Directive (2007/64/EC), nor under the Austrian E-Money Act (“E-Geldgesetz”) implementing the EU Electronic Money Directive (2009/110/EC). This is because lacking an electronic money issuer, Bitcoin does not fulfill the definition of “electronic money” laid down in Austrian legislation implementing the Electronic Money Directive.

We are also of the opinion that an operator of exchange services does not “issue and administer means of payment”, which would require a banking license under Austrian law. We are therefore of the opinion that the provision of (a) exchange services is not subject to Austrian deposit-taking/banking regulation and does not require an Austrian banking license. In our opinion, the same is true for (b) tools for accepting Bitcoin for online services, as we consider such tool or software as merely facilitating the acceptance of Bitcoin but not constituting a payment instrument according to the Payment Services Directive. Furthermore, we do not consider a tool for accepting Bitcoin as triggering a payment processing contract under civil law. Speaking of civil law, we come back to the block-chain technology which we consider a milestone in history, that we come back to the block-chain technology which we consider a milestone in history, allowing the “programmability” of money.

The instant payment method can also be combined with other non-bitcoin related products and services, such as the online access to music, movies or software as soon and as long as the virtual money flows. For this functionality, national civil, e-commerce as well as data protections laws need to be followed, compared to e.g. online tar-geting or tracking tools, where the customer’s prior consent is crucial.

Bitcoin as broadly accepted digital currency is also subject to the request for a preliminary ruling filed to the Court of Justice of the European Union (CJEU) by a Swedish Court regarding the tax status of Bitcoin. The outcome of this referral in case C-264/14, Hedqvist, on the qualification of Bitcoin from a value-added tax (VAT) perspective, will further decide on the fate and success of cryptocurrencies in Europe. As there is currently no provision within the EU VAT-Directive applying specifically to digital currencies, the CJEU is requested to decide whether or not Bitcoin transactions are subject to VAT rules and/or exempt from taxation. The CJEU’s ruling is expected within the next months. It is also expected that Bitcoin businesses could suffer an economic setback, if the CJEU decides to impose VAT, which, is e.g., 25% on the purchase price in Sweden, 20% in Austria or 19% in Germany. Some EU Member States such as Denmark, Belgium or the UK currently classify Bitcoin trading as VAT-exempt, which is widely seen as a competitive advantage in attracting investors to these countries, which are already developing as European “Bitcoin-hubs”. Other tax authorities, such as in Germany and Austria, tend to apply VAT and might (in the long run) force Bitcoin businesses to relocate to other more “bitcoin-friendly” countries. For solid economic reasons, when the CJEU issues its decision, the global currency industries will be paying close attention.

Although the cryptocurrency industry is still at the start, we see a high potential for the phenomenon of cryptocurrencies to evolve and – after taking several legal and taxation hurdles – to enter fully into the mainstream commercial market. When it comes to regulation, regulators do not need to “reinvent the wheel” and to call for brand new (re-)regulation and legisla-tion; it is rather the application of already existing rules for AML/KYC which can and shall be applied, both, for the sake of the needed general acceptance by the customer of tomorrow as well as for consistency and overall compliance.

**ARThUR STADLER** is a lawyer at Brandl & Talos Attorneys at Law, in Vienna / Austria and specializes in European Union law, e-commerce, Internet law and Austrian and international Gambling law. He is a frequent lecturer at conference, also on Bitcoins at home and abroad, as well as author of the first legal Vademecum on Bitcoin in Austria [Bitcoins (2014), edition Jan Sramek].

stadler@btp.at