



## ASSESSING THE LEGALITY OF VIRTUAL CURRENCY TRANSACTIONS

The core focus of this discourse is to elicit the factors which gave rise to the use of virtual currency such as “Bitcoin” and to assess its legality in international Law.

A useful starting point would be to consider the nature of traditional money and its purpose. Prior to the advent of fiat money, which operates as a medium of exchange, people



bartered to obtain goods and services. In a barter economy, two individuals possessing goods that the other desired, would agree to trade their goods. With time, the barter system soon proved inefficient, owing to the need for trading parties to transact with only those who would mutually benefit by transacting with them and more crucially, the lack of clarity as to the socially accepted values of goods and services consumed by people.

Having tested several forms of physical currency, the developed world largely settled with fiat money, which is simply

defined as ‘currency declared as legal tender by a Government’. The value of fiat money is based on the basic principles of demand and supply. Crucially, because fiat money is supported by Governments, consumers maintain confidence in its usefulness.

In contrast to fiat or physical money, virtual currency is ‘a digital representation of value that is issued and controlled by its developers, and used and accepted among the members of a specific (virtual) community’ and unlike regular money, relies on a ‘system of trust’ and is not ‘issued by a central bank or other banking authority’.<sup>1</sup> Virtual currencies emanated from a complex mix of factors such as, innovation and also strong opposition to government controlled monetary systems which have been cited to be the cause of both inflation and financial crisis.

Of all virtual currencies, ‘Bitcoin’ is the most widely accepted, as it ‘accounts for approximately 90% (approximately \$4.8bn

out of \$5.3bn) of total market capitalization which consists of more than 650 virtual currencies'.<sup>2</sup>

A simple peer to peer cash system enables Bitcoin users to pay for goods and services in accepted venues by placing their mobile phones near a receptor to transfer funds. In the Bitcoin system, control of money is decentralized and as such, individuals need to place a great degree of trust in one another for the system to function effectively. Transactions in the Bitcoin system are somewhat anonymous as there is no requirement for provision of names; account numbers and encryption codes are utilised to authorise transactions.

So what is the legal status of the Bitcoin? It is worth mentioning that, the use of Bitcoin remains contentious for regulators, who make continuous attempts to control the system. National currency is 'a form of money and therefore we can refer to the Indonesian Rupiah in Indonesia, the Czech koruna in Czech Republic, and so on, but the same cannot be said about Bitcoin, which is not legal tender in any country'.<sup>3</sup> Thus, we can infer that whilst Bitcoin is recognised by its users, it does not have the support of national governments to warrant its classification as legal tender. An illustrative example of how Bitcoin fails to meet the legal definition of electronic money would be to cite Czech legislation. Section 15 (subsection 2) of the Czech Payment Services Act defines electronic money as monetary value which '(a) represents a claim to the issuer, (b) is stored

on an electronic means of payment, (c) is issued against receiving of funds in the value not less than the value of issued electronic money and (d) is accepted as means of payment by persons other than the issuer. Where Bitcoin fails to meet the criteria of electronic money is that 'only banks, foreign banks, foreign or domestic credit unions or the Czech Central Bank' can issue electronic money.<sup>4</sup>

As Czech Law is derived from European Union Law, it goes without saying that Bitcoin does not meet the European Union's definition according to Directive (2007/64/EC). However, while the Czech Central Bank has stated that trading in Bitcoin is not subject to its supervision and that transacting in Bitcoin is not a problem, its directives also emphasise that 'systematic denial of domestic money as payment for goods and services already meets the definition of a criminal offense'.<sup>5</sup> The directives of the Czech Central Banking authority reveals two clear positions; that while Bitcoin is not legal currency, it can be used by individuals but only as a supplementary form of money which does not attempt to replace domestic currency.

Despite much opposition, Bitcoin usage is more accepted in some regions than others. For its enthusiasts, Bitcoin is an attractive alternative to fiat money for the following reasons. Firstly, it is accessible and all that is required is a computer or smartphone to open a Bitcoin wallet and begin trading in Bitcoins. Secondly, Bitcoin has the greatest

global  
outreach  
and usage  
of any



virtual currency. The nature of the decentralised currency diminishes the power of a Central Bank to print money at their discretion and so this drastically reduces the likelihood of inflation and by extension, financial crisis. In addition, minimal fees apply to Bitcoin transactions and one's account cannot be frozen. Bitcoin payment network now enables you to buy a very wide range of goods and services. More importantly, the need for individuals to use encryption codes for each and every payment curbs the likelihood of fraud, money laundering and other financial crimes.

Bitcoin has seen a greater degree of acceptance in the following countries:

### Nigeria

In Nigeria, the Central Bank of Nigeria (CBN) has received Bitcoin with more interest than scepticism for reasons such as its global availability and lower transaction fees. CBN also highlights the rapid rate of growth of digital payments in the country in the past few years and as such sees digital transactions gradually replacing fiat transactions in the country. The CBN has put together a committee to conduct an in-depth study of Bitcoin with a view to better understanding the benefits of its operation. While Bitcoin may not be embraced as national currency in the near future, it is interesting that CBN is keen on harnessing the opportunities of trading with Bitcoin.

### USA

In the USA, much progress has been made in regulating the use of virtual currencies; New York's BitLicense was the first virtual currency-specific licensing regime to address Bitcoin and digital currencies in the country. The categorisation of Bitcoin as property implies that American property taxes must be paid on Bitcoin transactions. Despite its regulation, the American monetary system still fails to recognise Bitcoin as legal tender.

### Cyprus

Historically, an offshore financial services hub, Cyprus has embraced the Bitcoin with enthusiasm and aspires to be a hub for Bitcoin business in the EU and surrounding territories. Cyprus is also home to the first physical Bitcoin savings institution called Neo.

### Germany

Germany is the most advanced in the regulation of virtual currencies by categorizing Bitcoin as a form of private money and also exempting transactions held for over one year from 25% capital gains tax. In typical liberal Dutch style, in Holland, Bitcoins and other digital currencies are accepted as currency and therefore have defined tax guidelines.

Aside from the few aforementioned contexts, where Bitcoin has been received with relatively open arms, the average position of Governments globally towards this crypto-currency is most justly described as hostile and perhaps, with good reason. The greatest fear of government with the use of Bitcoin or

virtual currencies is tax evasion which is an offence in many jurisdictions. Canada announced that it would tax transactions where virtual currencies are used to pay for goods and services under its barter transaction rules and also that profits made on commodity transactions could be subject to income or capital taxes. In Bolivia, the Government took a much tougher stance on virtual currencies by banning any currency not 'issued or regulated by government. Ecuador, in July 2014, did the same.

The EU's banking regulator, the European Banking Authority (EBA) issued a statement, warning of investment risk, fraud, tax evasion and other crimes connected to virtual currency use.

The French were swift in declaring that all digital transactions would be subject to taxation.

The Chinese government in 2013 banned financial institutions from transacting in Bitcoin. A subsequent statement just ten days later saw the ban on third party payment processors from dealing with exchanges. This monumental policy saw the price of Bitcoin crash by about 50%.

Simply put, Governments are far more sceptical about the pervasive rise of Bitcoin transactions than they are enthusiastic about its innovative structure and economic potential. Worth realising, is that most of these fears are well founded. A few problems with the Bitcoin system are highlighted below;

- a. With Bitcoin, there can be destruction of entire data

repository to the relevant Bitcoin account as experienced by a British man named James Howells, who threw away his computer disk wallet containing 7,500 Bitcoin and lost it all. In addition, loss of ones' password means permanent loss of access to that account. This pales poorly in comparison to cash money managed under a centralised system where accidental payments can be reversed, fraudulent transactions blocked -and account-ownership reconciliation can be made through established processes. Bitcoin enthusiasts are limited to using the payment system only where it is acceptable. As result of its decentralised structure, 'Bitcoin transactions cannot be reversed, except refunded by the receiver.

- b. Furthermore, the price of Bitcoin is highly volatile owing to the varied degree of responses different economies have towards the digital currency which ranges from permissiveness to outright hostility. Given this, speculators are advised heavily against unrestrained buying of Bitcoins in anticipation of a bullish market for Bitcoin prices.
- c. Contrary to initial public opinion, Bitcoin transactions are not anonymous, because all Bitcoin transactions are stored publically on the network; enabling anyone

access to view transactions for any Bitcoin address.

- d. Finally, Bitcoin is an experimental currency it is inherently less stable in comparison to cash money.

In conclusion, while virtual currencies are a form of private money which can be used to make purchases, they do not generally meet the legal criteria to be defined as national currency because they are not centrally controlled and as such, difficult to tax, regulate and also mitigate against the

harmful effects of financial criminals. Several Governments have already issued guidelines as to the use of virtual currencies to provide clarity in the short term. The Laws regulating Bitcoin transactions will surely grow considerably as understanding of the system and capacity to streamline its operation with legal tender improves. But for the time being, Bitcoin remains outside of legally recognised money and will continue to operate as an alternative means of payment for private purchases.

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