

Cryptocurrencies: money laundering and taxes

[Economics](#), [Currency](#)



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The future economy will be the economy of networks - with increasing role and power given to individuals (Mikolajewicz-Wozniak and Scheibe, 2015). As Bitcoin is seen as a currency of the people. Therefore it is reasonable to say that its power and popularity will increase and the system will go mainstream. The increased number of users could be explained as a consequence of the low trust in current banking system and fiat money.

The legal status of cryptocurrencies is not clearly determined globally. The lack of control over the system in conjunction with decentralization make establishment of a domestic legal environment pointless. Besides, the absence of framework administrator makes it hard to enforce exact rules and to demonstrate the applicable law and authorities. This makes the cryptocurrency system difficult to be controlled. Governments should find way to control the system taking into account its growing popularity and the significant increase in the number of users. The best way to control one system is to create rules for using it. But creating rules and legislation on a national base is not sufficient. These rules should be matched over the world because the gap between them will be imposed by criminals. Understanding

the importance of the cryptocurrency and its growing popularity some countries recognized it as a legal tender, others banned it and others even have not been decided yet how to treat it.

In European Union there is no any cryptocurrency declared as an official currency of a state. Also cryptocurrencies do not have physical formats, are not backed by law and do not have a legal tender capacity. Therefore, no creditor is obliged to accept payment with it to discharge a debtor of its debt. This means that virtual currencies can be used only as contractual money, when there is an agreement between buyer and seller in order to accept a given virtual currency as a means of pay.

Currently, digital currency is described by the European Central Bank (ECB) as it does not have a legal status at all, it is unclear and the key actors are generally neither regulated nor supervised. ECB highlight that users do not benefit from legal protection such as redeemability or a deposit guaranty scheme, and are more exposed to the various risks that regulation usually mitigates (European, 2012). Cryptocurrency exchanges or trading platforms could be registered in Europe but they are generally still unregulated.

Currently, most of the cryptocurrency traders acting in Europe do not have to comply with minimum capital requirements or other safeguarding obligations. Therefore there is no compensation mechanism in place in case of bankrupt or fraud and cryptocurrencies` users are not protected by the government and do not have any refunds rights.

European legislation do not recognize cryptocurrencies as money because did not meet fully the three features of money defined in the economic

literature examined above in this report. Firstly, ECB determine that cryptocurrencies have a limited function as a medium of exchange because they have a very low level of acceptance among the general public although this could be argued because the number of places accepting bitcoin and other cryptocurrencies increase constantly. Secondly, the high volatility of cryptocurrencies` exchange rates renders them as useless as a store of value even for short-time purposes. Finally, it is deemed that is not suitable as a unit of account.

In contrast to the legal status of cryptocurrencies in Europe and that is not deemed as a medium of exchange is the increased popularity and usage. Furthermore, in 2018 completely new 80, 000 places are expecting to start accepting cryptocurrencies as a payment method (BTCDirect, 2018).

Money laundering

Bitcoin assumes no connection between the addresses and actual identities. No screening or anti-money laundering checks take place. This leaves opportunities for exchange of currency based on illicit activity or criminal proceeds. A coin`s history can be traced to connect identities to addresses. Moreover, in most VCS, transactions are hard to trace, as the beneficiary is known only by its VCS “ address”, and not by its name and postal address (ECB)

Nowadays, bitcoin can be used as a cyber enabled crime which is a crime enabled by computers and Internet (hacking and malware) or as a cyber assisted crime (crime assisted by computers and Internet - online drug

trade). In the two cases bitcoin is considered as an empowering agent of the advanced criminal endeavor.

Bitcoin can be used also for cash-out money laundering strategies.

Cybercrime proceeds are usually in a fiat currency, such as Euros or Dollars.

At that point the bitcoin framework is utilized as part as anonymisation or layering process of cash-out laundering.

Bitcoin laundering could be achieved with enhancing its privacy: bitcoin mixers and bitcoin exchanges. Bitcoin mixing services are services that aim to disassociate bitcoins from their often-criminal source. Bitcoin exchange services are services that aim to anonymously convert bitcoins to spendable money.(van Wegberg et al., 2018). Understanding the strengths and weaknesses in this strategy will enable creating better evidence-based countermeasures for money laundering, ideally corrupting the underlying business models.

As the world is changing consequently and the types of money laundering change. There are a lot of different ways of money laundering known to the authorities. But following the globalization and changes in the banking and payment systems the new-payment methods become prominent in money laundering schemes. Significant part of these new payments takes the cryptocurrency.

The main facilitators for using cryptocurrencies in money laundering schemes are the underground markets. These markets provide for selling

illegal stocks as well as mixing services and exchanges. They could be accessed easily.

Tor-protocol

The anonymity of bitcoin is based on using pseudonyms but at the same time the wallets addresses which receive or spend bitcoins are visible in the blockchain. These two facts could be seen as milestones in the money laundering feature of cryptocurrencies. As the wallets addresses could be traced through the IP address used the Tor-protocol has come in use in order to hide the footprints of the transaction. The Tor-protocol makes possible to use Internet without revealing the originating IP address of the computer that is used to access the Internet(van Wegberg et al., 2018). Despite its openness, the bitcoin system does provide a high level of anonymity. The reason for this anonymity is that bitcoin addresses are not registered to individuals, in contrast to bank accounts. In addition to its degree of anonymity, bitcoin relies on the instant creating of new bitcoin addresses.

Mixing services

Bitcoin mixing service is a service which provides customers with a completely new generated bitcoins in respect of their old ones. This is achieved by overlaying protocols in order to hide the flow of funds among set of participants.

There are a lot of known strategies for mixing which accomplish diverse levels of protection, security and effectiveness. They could be differentiated by the way of relation between the parties. Some of them are (van Wegberg et al., 2018):

<https://assignbuster.com/cryptocurrencies-money-laundering-and-taxes/>

Centralized mixers - it use trusted party as a mixer. The mixing service is paying out other bitcoins from its reserves to bitcoin provided by the customer, after deducting a mixing fee. In order to achieve complete anonymity of the laundered bitcoins, the mixer is paying out the new bitcoins are spread out over time. After the `dirty` bitcoins are mixed the chance of finding a link between the deposited and received bitcoins is zero.

Peer-to-peer mixing solutions - this mixing is using intermediate party and exclude the need for mixing fees. This type of mixing is achieved by the possibility of the bitcoin transaction to contain multiple inputs and outputs addresses. Therefore it is possible person to combine its payments by different wallets to match the cost of the purchase. This type of mixing could be used by criminals very efficiently by creating a lot of wallets and matching payments by using all of them.

Bitcoin exchange

Bitcoin exchange is used after the mixing service is completed. This allows criminals to receive exchanged bitcoins without revealing its identity. In comparison to the ordinary techniques of money laundering the cost of laundering bitcoin is significantly lower (around 15%)(van Wegberg et al., 2018). Therefore probability of using bitcoins for laundering has a high degree of likelihood. Most notably, the ability to lower the cost of laundering, whilst providing more anonymity, make it an interesting money laundering techniques for criminals.