

What is crypto currency

Cryptocurrency such as Bitcoin, is a decentralized digital currency that uses encryption to verify transactions. Cryptocurrencies act as an alternative to traditional currencies such as, US Dollar (USD) or Pound Sterling (GBP) which are backed by a centralized government. Notably, although Bitcoin is the most commonly known cryptocurrency, there are over 1,200 others in existence.

Since the beginning of 2017, the aggregate market value of all cryptocurrencies combined has risen by around 1,800% to \$336 billion. The two largest cryptocurrencies, Bitcoin and Ethereum, have grown to the rounded percentage of 1,000% and 5,500%, respectively.

These huge gains, in just over 11 months, are entirely unprecedented in the world of finance. Based on these present valuations, it's easy to understand why there is a hype surrounding cryptocurrency and Bitcoin. In simple terms, if you bought one Bitcoin in 2015 you paid on average \$200 – assuming you held onto that Bitcoin today it would be worth an average \$15,000 - not a bad investment.

However, despite it's seemingly large money making potential, cryptocurrency stands as a high risk investment. The cryptocurrency market is exceptionally volatile, unlike national currencies, investors cannot rely on protection by the banks for malicious practice prevention, counterfeiting controls, related interest rate adjustment or many other important currency management decisions. It's also incredibly difficult to track a cryptocurrency, as it tends to flow through less familiar international channels (as opposed to bank accounts) so, once a payment is sent, it's irreversible regardless of whether the recipient is legitimate, or not.

How cryptocurrencies work

After vendor and recipient agree to process their exchange using a cryptocurrency, the digital transaction is recorded on the blockchain (a public ledger that records every transaction). The blockchain is the fundamental backbone, enabling cryptocurrency such as Bitcoin, to exist.

What is the Blockchain

At its very simplest form Blockchain is the decentralized ledger, from which a cryptocurrency transaction is recorded. Blockchain technology is an incorruptible digital ledger of economic transactions, that can be programmed to record not just financial transactions but virtually everything of value through smart contracts.

Information held on a Blockchain exists as a publicly shared and continually reconciled ledger. The advantages of Blockchain are huge – the database isn't stored in any single location, meaning the records it keeps are truly public and easily verifiable. With no centralized version in existence it means it's protected from manipulation for example, by governments or hackers. Blockchain technology establishes a peer-to-peer network within one system, so it cuts out the time and costs of intermediaries (the "middle man") and the complexity of using disparate ledgers and processes which exists throughout the lifecycle of any other transaction. As blockchain runs on codes, the transactions are **anonymous** - and this is the most concerning aspect of cryptocurrencies for the UK government.

Cryptocurrency and money laundering

Because cryptocurrencies are so flexible and indeed anonymous, they can and have been used for nefarious purposes.

Abuse of cryptocurrencies, typically on the black market, has undeniably given it an image problem - an example of this is the Silk Road takedown involving a massive international drug ring operating on Bitcoins.

The London Metropolitan Police report that drug dealers (especially small time dealers) are embracing currencies like Bitcoin, Litecoin, and Ethereum to stash drug profits without being caught. This is due to the 77 cryptocurrency ATMs that have opened up across the UK, typically in newsagents, allowing individuals to deposit cash for cryptocurrency, without the medium of a bank account – arguably making transactions even more anonymous.

Due to its surge in popularity and large scope for abuse by criminals intending to use cryptocurrencies for money laundering and tax avoidance purposes, the UK Government is increasingly keen to regulate the digital currency market - but the issue is how?

Present legal position

UK law surrounding cryptocurrency is unclear. Whilst The Treasury have stated their intention to regulate cryptocurrencies (specifically cutting at the heart of its anonymity) under European Union anti-money laundering rules, which would force cryptocurrency traders to disclose their identities and require online currency trading platforms, to carry out due diligence on buyers, any action is yet to take place.

At this present moment Bitcoin remains unregulated and is considered as a 'foreign currency' for most purposes, including VAT. In the UK it is legal to purchase, own and trade Bitcoin (and other cryptocurrencies) with no VAT due on the value of the Bitcoins themselves. However, as soon as they are exchanged for sterling or foreign currencies such as, euro or dollar, the normal tax, VAT and money laundering laws come into action with any profits and losses on cryptocurrency subject to capital gains tax.

Issues with regulation

Admittedly, regulating cryptocurrency is no easy task.

The market is exploding at an alarming rate and in part, regulation is held back by the Governments' inability to define what Bitcoin actually is. For example, some countries are treating it as a commodity and other places are treating it like a currency which impacts the way it is to be taxed. In the UK alone, Bitcoin is used as a currency in Camden market, where it can be exchanged for coffee at hipster cafes but it is also traded, in much larger quantities on Global Exchanges like a commodity.

Further, working out how large the cryptocurrency market is difficult, given the secretive nature of Bitcoin. A Bank of England report released in 2014 said that only 1.2pc of Bitcoin trading was against sterling. However, the popular Bitcoin exchange platform Coinbase said it had seen in December 2017, a fivefold year-on-year increase in the number of UK users.

Benefits of regulation

Financial commentators believe that insufficient regulation of cryptocurrency could be holding back the growth of the UK tech and start-up market, rather than creating opportunities through lack of regulatory constraints. This is because start-ups and other innovative businesses are increasingly seeking to use cryptocurrency but do not wish to do so in the UK, until the legal status is transparent.

Japan has taken the global lead on regulating Bitcoin. Earlier this year they introduced legislation to protect owners from being stung by a financial collapse by, for example, hackers, while also making Bitcoin exchanges comply with anti-money laundering regulations and officially authorising it as a normal payment method.

Arguably, what the UK needs is regulation to both give the cryptocurrency community the protection it needs to embrace this rapidly dominating currency and equally appease Government fears of cryptocurrencies being utilized on the black market for criminal purposes. In the midst of confusion in the UK surrounding regulating Bitcoin it appears that Japan has created the perfect framework for every digital currency out there. So, what are we waiting for?



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