

European Union

Virtual Currency Tax Evasion May Need a Multilateral Fix



By Linda A. Thompson

EU nations should take a united stance against tax evasion involving virtual currency, a problem that is likely to increase on a global scale in the coming years, practitioners told Bloomberg Tax.

The emergence of virtual currencies like Bitcoin, Ripple and Litecoin has been marred by concerns that criminals are using them, a development that threatens to undo much of the EU's progress against tax evasion. And while the EU has pinpointed it as a problem, the bloc doesn't have any anti-money laundering legislation that covers virtual currency, leaving a hole, practitioners said.

Cryptocurrency can be used to shield illicit money from tax authorities much like wealth can be hidden in a tax haven. Or, revenue earned by a business that accepts virtual currency may never be reported to tax authorities.

The EU will aim to remedy this when the European Parliament votes on the 5th Anti-Money Laundering Directive next month, said Claire Harrop, an associate at Freshfields Bruckhaus Deringer LLP. It is expected to enter into force in 2019.

"The idea is to apply the same sort of procedures in the virtual currency world as currently apply to banks and other financial institutions" and to impose know-your-customer obligations, which require service providers to verify the identity of their clients, she said.

Snapshot

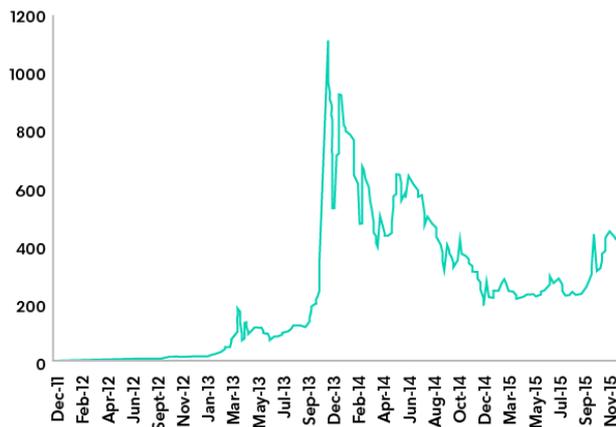
- Virtual currencies being used to evade taxes, launder money
- Global regulatory response needed, practitioners say

Volatility of Bitcoin

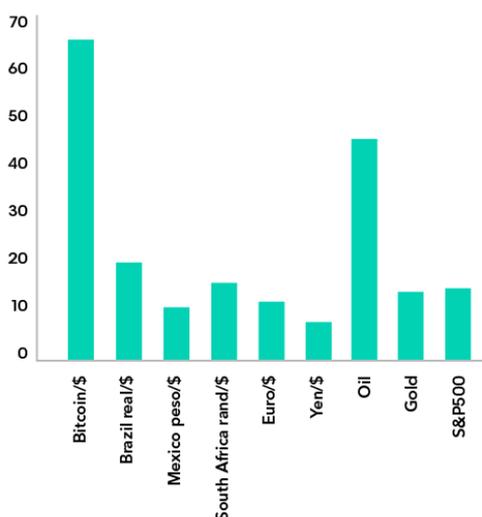
Bitcoin prices have been extremely volatile over the past several years...

...and more volatile than any other key currencies and assets.

The Value of Bitcoin
(U.S. dollar per bitcoin)



Volatility of Bitcoin and Selected Currencies and Assets, 2015
(Standard deviation of daily price changes, annualized in percent)



Source: IMF Staff Discussion Note, Virtual Currencies and Beyond: Initial Considerations, January 2016

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Where to Turn?

Practitioners warned of the complexity of addressing virtual currency-related tax evasion.

"This is a global phenomenon; tax authorities recognize the vulnerability of cryptocurrencies because of their anonymity. But at this stage, I don't think they know how to best respond to it," said John Christensen, director and chair of the board at the U.K.-based advocacy group Tax Justice Network.

With cryptocurrencies, a virtual and borderless tax haven is emerging that will be even stickier to address because there is no one to turn to or sanction, Christensen said.

As governments increasingly share tax information about their citizens, the tax evasion associated with virtual currency may grow in parallel, he said.

"There is a risk that in the coming decades, the cryptocurrency movement will become the default option for people who are wanting to engage not just in tax evasion, but in money laundering and in a range of other corrupt practices," he said.

In its current draft form, that directive contains loopholes, Harrop said. Its anti-money laundering provisions, for instance, only apply when fiat currencies are converted into virtual currencies, but not when virtual currencies are converted into other virtual currencies.

"If I wanted to change something between Bitcoin and Ethereum, or Bitcoin and Litecoin, this directive doesn't apply," Harrop said.

The issue is an "important topic" for Europol, the Hague-based law enforcement agency of the European Union, spokesman Jan Op Gen Oorth said. Virtual currency is relatively cheap, widely available, and lets users keep their information confidential—a combination that is ripe for fraud, he said.

The Largest Virtual Currencies

Currency	Market capitalisation (EUR Millions)	Price (EUR)	Available supply (number of units)	Volume traded in last 24 hours (EUR)
Bitcoin (BTC)	2,674	193.390000	13,828,700	12,702,120
Ripple (XRP)	392	0.012289	31,908,551,587	550,623
Litecoin (LTC)	56	1.530000	36,397,554	967,530

Source: European Central Bank, Virtual currency schemes – a further analysis, February 2015

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"We at Europol have identified an increase in the use of virtual currencies for money laundering activities. No longer an exclusive tool for cybercriminals, drug trafficking cartels are taking advantage of the possibilities," he said in an email.

The focus from top law enforcement officials within the EU comes as many countries are trying to find their own solutions to virtual currency tax evasion. Germany, Japan, Australia, and South Korea are among the countries grappling with how to tax virtual currency.

Global Solution Needed

The draft version of the EU anti-money laundering directive calls for virtual currency ledger-holders in EU member nations to register with EU authorities. But a money launderer in London using a ledger—a record of all the transactions in a virtual currency—or cryptocurrency based in Singapore could escape the scope of the directive, because it doesn't apply to non-EU jurisdictions, said Andrew Beckett, managing director at the consulting firm Kroll in London.

To EU regulators, these virtual currency transactions between London and Singapore would simply look like encrypted traffic "going in and out" and not raise any red flags, he said.

"You can take cryptocurrencies anywhere in the world. Only blocking it in the EU isn't going to stop the problem," he said. "The very international nature of this means that a solution falls apart if it is not global."

Kim Helwegen, attorney at Jaeger Advocaten in Amsterdam, similarly noted that a country like the Netherlands shouldn't go it alone, but she leaned toward a different solution to curb cryptocurrency-based tax evasion and money laundering. Countries around the world should develop an open-source verification system that virtual currency exchanges can use to check the origin of cryptocurrencies, she said.

"International rules will have to be developed because this is the future," she said.

More Questions

Helwegen also said taxpayers who wish to duly report income earned from virtual currencies in their tax returns also are confronted with many "qualification questions" stemming from the nature of virtual currencies.

"There are not enough instructions and there is too much gray area," she said, pointing out that it isn't clear how the Dutch tax administration considers activities such as mining, or processing transactions in a virtual currency, and hard forks, a process that creates new coins from existing coins.

Lawmakers should embrace virtual currency and the Dutch tax administration should offer guidance to answer questions, she said.

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