

The quest for certainty in the Bitcoin world

Historically, national currencies were based on a gold standard, then gradually on the belief that the State which issues the currency will be able to guarantee its value and its stability. With the emergence of multiple financial and economic crises, the reliance on States and confidence in the financial industry have declined and virtual currencies, which were initially confined to a very few initiated people, gained the interest of an ever-growing part of the population. Bitcoin and other virtual currencies were initially the result of a "bottom-up consensus" from a minority of individuals who wanted to decide by themselves what they wanted to value as money, outside of any governmental or financial authority and thus free from any regulation.

More recently, the approach with regard to Bitcoin and other virtual currencies seems to be changing and their use, which was initially outside the banking system, may now be in the process of being integrated into the banking system allowing customers to benefit from the advantages offered by such systems (i.e. allowing banking transactions to be cheaper, faster and even more secured than before).

Luxembourg regulatory framework for virtual currencies

As of today, there is no specific legal framework regulating the virtual currencies ("VCs") in Luxembourg. However, the Luxembourg authorities and the Financial Supervisor (Commission de Surveillance du Secteur Financier, "CSSF") are fully aware that some tailoring is needed in order to adapt the current financial regulatory framework to reflect the challenges of new technologies, especially with regards to VCs. In this context, the CSSF issued a press-release on 14 February 2014, stating that VCs

shall be considered as scriptural money, as they are accepted as a means of payment for goods and services. Due to their nature, VCs may be considered as electronic money, but not necessarily within the meaning of the European Directive 2009/110 which defines 'electronic money'. In the same press-release the CSSF reminded that 'nobody can be established in Luxembourg to carry out an activity of the financial sector without an authorization by the Minister of Finance and without being subject to the prudential supervision of the CSSF'.

In practice, determining what can be considered as an activity of the financial sector can be potentially complicated due to the wide range of use that can be made of VCs. In other words, the distinction between an activity of the financial sector and a mere IT support to financial professionals may be quite blurred. Thus, the CSSF took the position to proceed with a case-by-case analysis of the business models proposed by each potential new stakeholder that intends to establish its business in Luxembourg.

Hence, persons contemplating to carry out activities in Luxembourg that involve issuing means of payments in the form of VCs, providing payment services using VCs or creating platforms to trade VCs, shall first contact the CSSF in order to determine if and what type of licence is required. This highlights the necessity for all future market players to seek legal advice and guidance when developing their business model in order to benefit from maximum predictability on the legal treatment of their activities.

Virtual currencies, between threats and opportunities

The risk of illegal use of the VCs (e.g. for money laundering purposes) due to their potential lack of transparency remains a major concern, highlighted by most experts across the globe. Indeed, the identity of the person holding the VCs and undertaking operations with such currencies is unknown to the other participants, even though some systems (e.g.

Blockchain) may provide information on the exchanges and the path of each Bitcoin. Thus, in practice, in order to avoid unexpected penalties from the competent authorities, some of the new stakeholders in the VCs market are now looking to be regulated and supervised or to work together with established financial institutions on which they may rely on for all know-your-customer and other obligations arising from the Anti-Money Laundering ("AML") laws, while some players prefer to continue with the initial approach of the VCs and wish to be totally unregulated.

The threat of a breach to the applicable AML laws and regulations has lead regulators and legislators to adopt a defensive stance with regard to VCs. A balance must be struck between the importance of a prudent approach, given the cross-border feature and the potential lack of transparency, and a predictable, friendly, and attractive business environment that does not undermine the freedom of undertaking in a nascent and creative field.

International regulatory framework for VCs

Despite the discussions between the European Banking Authority and the European Single Market Agency on VCs and their related reports, there is currently no project on international standards to regulate the use of VCs. However, at the European level, the European Commission proposal for a new Directive on payment services (known as the Payment Services Directive 2) may enhance the scope of the current legislation applying to payment services and potentially affect VCs' market players.

The main challenge for an international regulation of the VCs, will be to regulate VCs which are based on protocols, such as internet protocols, which themselves are not regulated at an international level. The question of internet regulation is not new and an attempt in that way was undertaken by the International Telecom Union ("ITU"). During the ITU conference in 2012, a proposed glo-

bal telecoms treaty giving national governments control over internet was discussed. However such proposal faced the opposition of several major countries, such as the United States and the United-Kingdom. Since the beginning of 2014 there have been many initiatives from the financial authorities in order to regulate or at least provide market players with guidelines on the use of VCs. However, the main challenge will be to mitigate the risks arising from the use of financial technology without impeding the development of these new technologies.

Luxembourg Tax treatment of VCs

As it relates to the tax treatment of VCs in Luxembourg, the treatment will very much depend on the characterization of VCs and such status has not yet been addressed by the Luxembourg tax legislation. In addition, it appears that the Luxembourg tax authorities have issued no administrative guidance in relation to VCs; nor have they undertaken any applicable practice in this regard.

Even if the CSSF stated, in the aforementioned press-release dated 14 February 2014, that VCs shall be considered as scriptural money and that, due to their nature, they may also be considered as electronic money, it cannot be excluded that the Luxembourg tax authorities may decide to characterize VCs as goods or other assets for Luxembourg tax purposes.

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