

# LEGAL APPROACHES TO THE REGULATION OF CRYPTOCURRENCY AND BUSINESS ETHICS OF ICO IN THE EUROPEAN UNION

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## ABSTRACT

*The article presents an analytical review of existing legal instruments for regulating the market of cryptocurrencies and ethical relations in terms of their circulation in the European Union (EU). The genesis of law and regulatory instruments in the field of virtual currencies within the EU were presented. The mechanism of legal interaction of the main EU institutions and regulators on the cryptocurrency market was presented, and the main problems and shortcomings of legal support for the functioning of the cryptocurrency at the current stage of development of the EU legal system were identified.*

**Keywords:** Legal System, Ethical Aspects, Regulatory System, Legal Interaction Mechanism, European Institutions, Cryptocurrency Market.

## INTRODUCTION

Today, in the conditions of instability of the world economy, changes in public sentiment, distrust of financial institutions, there is a growing interest in autonomous innovative financial systems in the form of cryptocurrency. The EU countries have quite vividly supported this financial product, but this has created the need for legal protection and security. Since the main purpose of the legal system is the effective regulation of real social relations that arise in European society, there is an urgent need to develop and improve the legal framework for regulating the circulation of cryptocurrency in the EU (Haentjens & Pierre, 2015). In scientific discourse, a database of studies of the financial nature and legal status of cryptocurrencies is being formed, but such scientific advances in this direction should be outlined (Bartlett, 2014; Faulkner, 2016). The international experience of legislative regulation of the functioning of cryptocurrency and ICO (Initial Coin Offering) is being actively studied (Arner et al., 2017; Enria, 2018). The purpose of the article is to single out the issues of legal regulation of the use of cryptocurrency and ICO procedures in the countries of the European Union.

## METHODOLOGY

The methodological basis for the study is the following provisions: (1) innovations in the field of “*production*” and cryptocurrency circulation have the potential to directly influence the traditional legal and ethical architecture of the EU, while the results of such an impact cannot be predicted; (2) the latest financial technologies have their advantages, but in the absence of systemic legal regulation, they form certain risks. Thus, the Advisory Document of the Basel Committee on Banking Supervision on the Implications of Financial and Technological Developments states that there is a need to define the conditions for regulating this sector of the EU financial system.

## RESULTS AND DISCUSSION

The emergence of blockchain technology has contributed to the development of new financial technologies, primarily, as expert’s note, in the financial and banking sectors, thanks to which new financial services and cryptocurrencies have emerged. At the present stage, none of the regulators of the European Union has adopted certain special rules for regulation and business ethics of ICO and the use of cryptocurrency. Taxation of transactions with it is carried out in accordance with the national legislation of the Member States of the European Union, depending on the nature of the cryptocurrency transaction. At the same time, as a rule, for the purposes of taxation, the EU member states consider cryptocurrency as an intangible asset or commodity, and not as currency or money. The term “*virtual (digital) currency*” is used instead of the term “*cryptocurrency*” by European regulators. However, it is considered as a means of payment. However, such an approach was criticized by the ECB (European Central Bank), which considers that the definition of a cryptocurrency as a virtual (digital) currency is an imperfect act. However, this does not contradict the need to establish a legal framework for anti-crime counteraction to crimes committed using a cryptocurrency. Given this formation of the regulation of the use of cryptocurrency, which is held under the auspices of the EU implementation of the policy of countering the legalization (laundering) of proceeds from crime and the financing of terrorism (Dabrowski, 2017). Let’s consider the crucial stages of strengthening the legal framework of the EU in the issue of regulating the circulation of cryptocurrency and ICO (Drobyazko, 2019; Drobyazko et al., 2019).

### Stage 1

In October 2012, the ECB presented a report on digital currencies and their potential in terms of legal regulation within the framework of European legislation. According to the report, “*virtual currency*” can be defined as the type of unregulated digital money issued and controlled by its developers and accepted by members of a certain virtual community. Virtual currency is one of the “*bidirectional flow*” virtual currency schemes that economic entities can buy and sell based on the exchange rate (Finck, 2017). Such virtual currencies are similar to other convertible currencies for use in the real world. Virtual currencies are different from electronic money, as defined in the Directive of the European Parliament and the European Council of September 16, 2009 No. 2009/110/EU, since, unlike this money, for virtual currencies, funds are not expressed in traditional accounting units, for example, in euros, but in virtual accounting units.

Thus, in June 2014, Sweden applied to the European Union Court (European out of Justice) for an explanation of whether a cryptocurrency transaction was subject to value-added tax (VAT). At the same time, this country expressed concern about the inconsistency of the approaches of the EU Member States to this problem. This appeal was caused by the fact that since 2013, bitcoins have been considered in Sweden as a legal means of settlement, the currency. In October 2015, the European Court of Justice issued the previous ruling, and in November of the same year-the full text of the Decision of October 22 in case C-264/14, according to which transactions on the purchase and sale of cryptocurrencies in traditional currencies are not subject to value added tax, equating cryptocurrency to other means of payment (currency), and not goods (European Authority, 2018).

## Stage 2

Later in 2014, Europol published a report entitled “*Organized Crime Threats Assessment on the Internet (iOCTA)*”, which for the first time drew attention to the use of cryptocurrency in criminal activity, mainly Bitcoins, indicated one of the trends of this - the use of virtual currency to launder proceeds obtained as a result of cybercrime, recognized the serious potential of virtual currency as an ideal tool for money laundering. Also later in February 2016, a draft report of the European Parliament's Committee on Economic and Monetary Affairs on the approach to the regulation of cryptocurrency was published. It concluded that it was necessary to refrain from direct regulation of virtual (digital) currencies (Herlin-Karnell & Ryder, 2017). However, the report of the Committee contained the possibility of controlling the circulation of bitcoins in accordance with the existing rules on countering the legalization (laundering) of criminal proceeds and the financing of terrorism. In addition, it was proposed to create a working group to address issues related to the cryptocurrency. Later this proposal was supported by the European Parliament.

## Stage 3

In February 2016, a decision of the European Council was published, emphasizing the importance of promptly making changes to EU legislation in the area of countering the legalization (laundering) of proceeds from crime and the financing of terrorism, given the inability to control the issuance and circulation of cryptocurrency in the EU. As early as July 2016, the European Commission made a proposal for a Directive of the European Parliament and the Council on amending Directive (EU) 2015/849 of May 20, 2015 on preventing the use of the financial system for the purposes of money laundering or terrorism financing and amending Directive 2009/101/EU. First of all, it was proposed to introduce compulsory licensing of the activity of cryptocurrency exchanges, as well as providers of virtual wallets. At the same time, it was planned to create a centralized database with information about users of virtual (digital) currencies (COM/2016/0450) (European Parliament, 2016). These proposals were submitted to the European Parliament for consideration, after which a broad discussion of the initiatives launched began in the institutions and member states of the European Union. Moreover, proposals were made on tougher legal regulation and control over the cryptocurrency.

#### Stage 4

In October 2016, the European Central Bank issued a Resolution on the proposal of the European Commission for the administration of the use of cryptocurrency, in which the ECB issued the following provisions (European Banking Authority, 2019):

1. Introduction of compulsory registration or licensing of cryptocurrency exchanges that exchange cryptocurrency for traditional money and reverse exchange; licensing of providers of virtual wallets;
2. Risk of imperfect use of the definition of a cryptocurrency as a virtual currency and means of payment was determined (according to the ECB, a cryptocurrency is more a means of exchange);
3. It was noted that the virtual (digital) currency is neither money nor currency; it means it is not part of the current legal regime for regulating currency relations in the territory of the EU.;
4. It was mentioned that the widespread use of digital currencies may adversely affect the ability of central banks to control money supply.

#### Stage 5

After such serious discussions at the level of the institutions of the European Union, numerous consultations and taking into account the views of EU member states in December 2017, the EU Council presented a proposal for the Directive of the European Parliament and Council (EU) 2015/849 on preventing the use of the financial system for money laundering or terrorism financing and amendments to Directive 2009/101/EU (final compromise version). Within the limits of the established legislative procedure on January 29, 2018, the draft Directive was approved by the specialized committees, and on January 30 a positive opinion was given by the Legal Committee of the European Parliament. The adoption of the Directive occurred on April 8, 2018. The European Parliament and Council Directive No. 2015/849 of May 20, 2015, on its own, on preventing the use of the financial system for the purposes of money laundering or terrorism financing (as it is called the “*Fourth EU directive on anti-money laundering*”) in general is aimed at preventing the use of the EU financial system for the purposes of money laundering and terrorism financing (Valcke et al., 2015).

Thus, the five stages we have identified on the formation of a legal framework for regulating the use of cryptocurrency and conducting an ICO in the EU countries allows us to professionally identify the main legal problems and risks that are being formed now and pass into the next periods of the EU financial system (Table 1). According to current decisions and directives, along with any operations with cash and property, operations with virtual (digital) currency fall under control, which is understood as “*digital representation of value that is not emitted or guaranteed by the central bank or government agency, which is not necessarily added to legally established currency, and does not have the legal status of a currency or money, but is accepted by individuals or legal entities as a medium of exchange and which can be transferred, stored and sold in electronic form.*” (Vereecken, 2003). So, the experience of the EU legal system and business ethics in regulation of the use of cryptocurrency and conducting ICOs can be spread throughout the world for national legal systems, which will significantly reduce the level of risk when using virtual payment instruments.

**Table 1**  
**LEGAL PROBLEMS, RISKS IN SPREADING THE USE OF CRYPTOCURRENCIES AND BUSINESS ETHICS OF ICO IN THE EU**

No. in seq.	Problem/risk	Severity of the problem	Scale of the problem	Dynamics of the problem	Importance of the problem	Priority of the problem
1	Unpredictable legal consequences of cryptocurrency activities	High	Huge	Unchanged	very high	High
2	Uncertainty issues of taxation and accounting of operations with cryptocurrency	Average	Large	Unchanged	High	High
3	Uncertainty of the need for licensing of mining and ICO	High	Average	Unchanged	very high	Non-priority
4	Inability to accept cryptocurrency as payment for goods (services)	Not high	Not large	Unchanged	Not high	Non-priority
5	Inability to enter into smart contracts using cryptocurrency	High	Not large	Unchanged	Average	Non-priority
6	Uncertain legal status of ICO	High	Not	Unchanged	Average	Non-priority
7	Protection of the rights of consumers of cryptocurrency and e-wallets	Not high	Large	Unchanged	Average	High
8	Uncertainty about the need for licensing cryptocurrency development services	Not high	Not large	Unchanged	Not high	Non-priority
9	Inability to export/import commodity products in exchange for cryptocurrency	Not high	Not large	Unchanged	Not high	Non-priority

## CONCLUSION AND RECOMMENDATIONS

The recommendations are formed on the basis that the EU system is supported by the position that the cryptocurrency gradually acquires the status of digital assets and this determines the need to develop the legal competencies of the authorized bodies that should regulate the circulation of cryptocurrency and ICO with regard to new developments and modern technologies.

It was determined that the legal practice of cryptocurrency circulation in EU member states is rather broad and relevant. Despite the lack of a unified approach to the financial and legal nature of the cryptocurrency, national legal systems proceed from the priority of protecting the fundamental rights and freedoms of their citizens, which is confirmed by a number of European directives. In addition, the EU Member States approve their own regulations to determine the mechanism of ICO, the use of business ethics and the taxation of cryptocurrency transactions with the aim of proper legal regulation.

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