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Insufficiencies in European Union Law and Member State National Law regarding cryptocurrency regulations and its illicit use

BACHELOR THESIS

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DECLARATION OF HONOUR:

I declare that this thesis is my own work, and that all references to, or quotations from, the work of others are fully and correctly cited.

(Signed) ……………………………………

Riga, 2022

ABSTRACT:

Cryptocurrency market transactions and provided opportunities for individuals have highly increased the use of this new paradigm for pursuing illicit activities. The European Union has reacted to this situation and have started to imply certain regulations to restrict criminal activities such as tax evasion, money laundering, terrorist financing and others. The aim of this research is to recognize possible insufficiencies in directives, normative acts and proposals provided by the EU. Understanding the problems within these regulations will help in the constant development and creation of a unified legislation for cryptocurrency users within the EU, and possibly indicate a roadmap for other nations. Recommendations on solving temporary legislative issues regarding the cryptocurrency market in the European Union will improve the overall legislation provided, and lift off some weight of the Member States amending National Laws in efforts of trying to restrict illicit use of this new digital market.

SUMMARY:

The research proposed by the Author is an analysis of the cryptocurrency market and the hardships of the European Union regarding legal regulations of this new trend. As the new digital market swept the world by introducing a new, decentralized way of pursuing transactions, it brought serious security concerns for the Governments, as the original financial system and the laws regulating it was being broken down since cryptocurrencies provided a chance to pursue criminal activities with complete anonymity. As it was not the aim of the cryptocurrency creators, individuals quickly took advantage and began avoiding taxes, laundering money, and even financing terrorist groupings through the new market. Since the new market is completely digital, without any physical currencies, state borders or government issuance, the European Union quickly reacted and made efforts of proposing ways of restricting access of criminal users. The EU realized that there is a need of a unified regulation, as it can be easily moved from State to State. While amendments were made, proposals discussed, and first directives becoming legally binding, the Member States were forced to create a national legislation regarding this new market with the hopes of restricting criminal users in their own country. For the illicit individuals this did not really create a major concern, as it still is completely digital. If member state A creates a sufficient National law legislation on regulating transactions, trades, registering licences and crypto wallets, the individual in question can move its transactions through State B, which has no National law legislation regarding cryptocurrency transactions. This situation completely derogates the efforts of member states trying to restrict this action, as it is simply pushed on to the next State – hence the necessity of a Unified Legislation. The European Union has taken up the challenge of a Unified regulation, as the world closely monitors their actions, to understand the next steps needed to be implemented into their own legislation. The research includes an analysis of directives issued by the EU and their potential flaws and insufficiencies. Agreements posing unproportioned restrictions and deliberating innovation that is highly held as a crucial value in the EU are analysed. Failure to create legally binding directives to overcome the anonymity principle is analysed to understand the further steps into fully regulating the cryptocurrency market within the borders of the European Union. The Purpose of the final recommendations and future intentions is to gasp the route EU should be pursuing to get step by step closer to achieving a fully functional, legally binding unified legislation in regulating crypto assets and its movements in the market.

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INTRODUCTION:

The development of technologies has provided the society with outstanding opportunities. The rise of the digital era, has given its users a new phenomenon – Cryptocurrencies. Created in 2009, the first currency of the new market called Bitcoin, lead the way for an entirely new approach of pursuing transactions without using a state issued financial market.[1]This new market has given the space for users to pursue transactions without a state issued entity, meaning – no government has created it. This new trend has given the opportunity to pursue investments, transactions, trades and many more actions with this new platform. The market poses new opportunities but at the same time state level threats. Since these transactions are either completely anonymous or pseudonymous, it poses serious security risks to private individuals and States. Since it is not a centralised market, this currency is not being governed by any State or any institution. The purpose of this research is to analyse how the European Union is regulating this new market. Since the EU has issued several documents and proposals, the author will analyse what loopholes and deviances they might possess. Since the regulation of this new phenomenon is quite new, there is a large amount of variance available for illicit users in this field. EU Member State national law will be observed and analysed in this research to see how these countries are trying to restrict criminal activities. A large amount of speculation is pursued regarding the cryptocurrency market and its potential developments. The nations world-wide are watching and observing the actions of the European Union, in a way the EU is the first scape goat issuing regulations. Other nations are observing to see if these restrictions will be successful before applying regulations in their own legislation.

Research Question – What is the reasoning behind the lack of unified legislation regarding cryptocurrencies, is the EU capable of making this type of regulation for its Member States?

Hypothesis: The European Union fails to create a unified legislation for member states and cannot sufficiently safeguard and regulate the cryptocurrency market to restrict illicit users of pursuing their criminal activities through these virtual currencies.

The research pursued by the author will consist of four chapters – first chapter will indicate a brief history of the cryptocurrency market to understand the origins and the trends of this new technology. Potential threats this market imposes will be analysed to understand the risks of a non-regulated, decentralized market. The cooperation between cryptocurrencies and the

[1] Stråle Johansson, Nathalie Tjernström, Malin. (n.d.). *The Price Volatility of Bitcoin*, p.1 https://www.diva-portal.org/smash/get/diva2:782588/FULLTEXT01.pdf

fundamental financial instruments will be analysed. The second part of the research will be concentrated on European Union Member States and their National laws on preventing criminal use of cryptocurrencies, and how it is an advantage for the illicit users, if a unified system is not adopted. The third part will consist of EU document and proposal analysis on regulating cryptocurrencies. Potential insufficiencies in this legislation will be analysed and indicated. Lastly, the fourth chapter of this research will be devoted to professional opinions. Specialist recommendations will be analysed to give a scope in the future steps on creating a unified legislation for regulating cryptocurrencies, to restrict, or best case scenario – prevent fully, the use of this new market for illicit actions.

1. DIGITAL MARKET OF CRYPTOCURRENCIES – HISTORY, POTENTIAL CRIMINAL USE AND COOPERATION

1.1 History of the Cryptocurrency Market

Cryptocurrency Market has swept the world in the past 14 years. To analyse the history and development of the cryptocurrency market, it is crucial to acknowledge how this new system actually works. As it is a new phenomenon, the technology used to pursue these transactions is something the general society has not seen before. It is completely different from the financial instruments' population has used before, this being part of the reason why people got so interested in this new trend. Cryptocurrencies and the transactions within the market are based on the Blockchain Technology. Blocks within the blockchain technology are based of components called nodes. These nodes contain the transactions made. As many transactions are being pursued at the same time, they create these blocks and are stored in the blockchain forever.[2] It is quite difficult to comprise the cryptocurrency market, and its coins into a one, clear definition. As it is a new phenomenon, which is still being studied by scholars, specialists and even government institutions, the most simple terms on defining this paradigm would be – a medium of exchange that functions like standard money, as it is possible to obtain goods and services with it, but it is untethered to, it is independent from national borders, central banks, sovereigns or fiats.[3] To put it more simply - The cryptocurrency market is a decentralized market, meaning that no government actually created it, is managing it or governs it. For example, the EURO is a centralized currency, but a Bitcoin, is a decentralized cryptocurrency. As it is a quite difficult concept to gather at first, it can be explained quite simply. To better understand the difference, figure 1 is provided indicating various authority systems and how these systems differ from each other.

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[2] Mark Gates, "Blockchain – the ultimate guide to understanding blockchain, bitcoin, cryptocurrencies, smart contracts and the future of money" Page 208. Accessed on May 7, 2022

[3] "CRYPTOCURRENCY: A PRIMER." p.1 Latham & Watkins LLP -. Accessed May 6, 2022. https://www.lw.com/thoughtLeadership/cryptocurrency-a-primer.

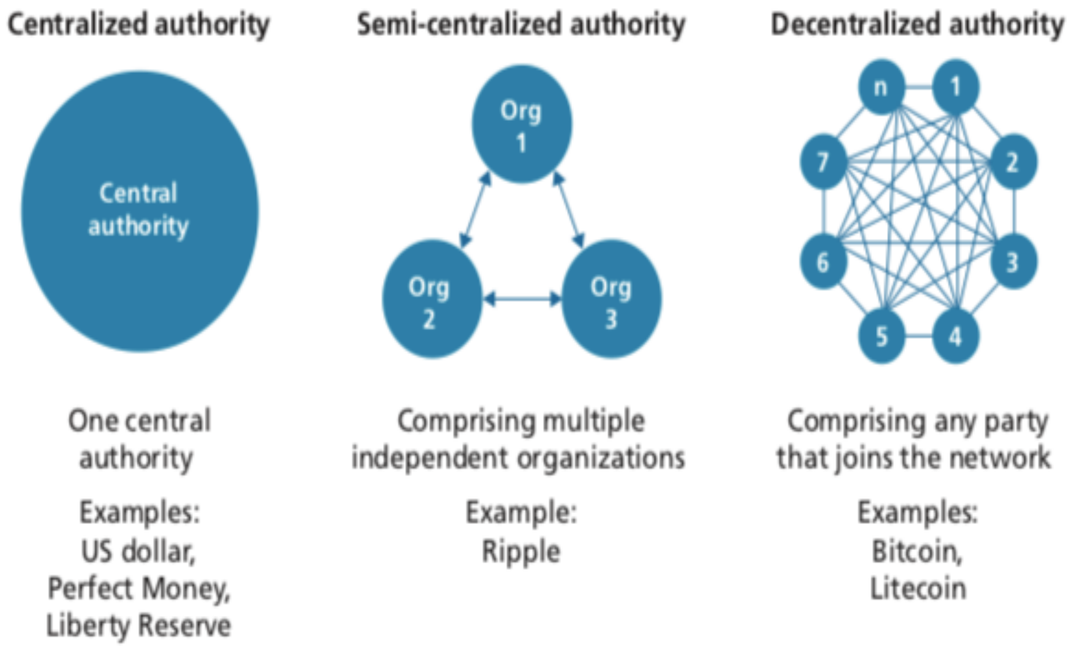

Figure 1. "Virtual Currencies Have Varied Authority Structures" [4]

As the Figure 1 indicates, there is a clear difference between a centralized, and a decentralized market. With the centralized market, there is a central authority which governs the processes being pursued within this authority. The difference from this system and the Decentralized, cryptocurrency system, is the fact that each person or party who decides to join the cryptocurrency market, is a part of the whole system. It is based on a cryptography system, meaning that every action is registered, every party is a part of the whole crypto market "web", and cryptography makes the trades and transactions secure and possible to verify, but at the same time poses the chance of anonymity.[5] Every transaction made within the cryptocurrency

[4] Baron, Joshua, Angela O'Mahony, David Manheim, and Cynthia Dion-Schwarz. "The Current State of Virtual Currencies." In *National Security Implications of Virtual Currency: Examining the Potential for Non-State Actor Deployment*, 5–22. RAND Corporation, 2015. http://www.jstor.org/stable/10.7249/j.ctt19rmd78.8.

[5] *Supra* note *2*

market is recorded, but the individuals pursing in these transactions can stay hidden, without indicating their identity to government institutions.

By the introduction of cryptocurrencies, a new possibility of pursuing transactions was given to the society. The acquaintance of virtual currencies, a new way of transferring funds and investing capital was provided when creating the first ever cryptocurrency – Bitcoin. Up to this day, the creator of Bitcoin is still unknown. The concept of Bitcoin was first made public in a 2008 paper by the pseudonymous Satoshi Nakamoto and its first client software appeared the following year.[6] The individual, or perhaps a group behind the pseudonym "Satoshi Nakamoto" created an article indicating to the world that a new possibility, a new concept of money is coming. The launch of Bitcoin was in 2009, creating a path for a technology the society was not ready for. The new concept took some time to gain the interest of the public. As it goes with new trends, people looked at it very sceptically at the start. Fear of change was the reason why people were not running to invest in this new opportunity, because it deliberated everything the society knew about financial transactions.

For more than a year after the launch of the first cryptocurrency – Bitcoin, its price remained at 0, but shortly after people started to understand the benefits and potential opportunities of investing and pursuing transactions through this market, the price of Bitcoin started to fluctuate in an upwards trend. The demand and interest sparked, making Bitcoin more popular to the general public, and not only specialists closely observing the potential rise of the cryptocurrency market. Since the creation of Bitcoin, thousands of different virtual cryptocurrency coins have been created, yet the so-called original coin has stayed at the top of the list, currently being worth 36'000 Euros per coin.[7] The creation of different cryptocurrencies lead to the opportunity for people to choose from a wide range of options, depending on the individual needs – trading, investments or just purely for transaction purposes. Since every transaction is being recorded, the user can choose a different coin to better suit their purpose – whether its investing, trading, long term holding or simply for the purpose of obtaining goods and services with the help of this new phenomenon.

The anonymity of cryptocurrencies poses a threat of illicit activities on the market. Further, the author will discuss the possible criminal actions individuals are pursuing through this new market, and how the adoption of this market into the public may become a general security threat for any country, if not properly regulated.

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[6] "Who is Satoshi Nakamoto?"Accessed on April 2, 2022. https://go.gale.com/ps/i.do?id=GALE%7CA348215741&sid=googleScholar&v=2.1&it=r&linkaccess=abs&issn=01470590&p=AONE&sw=w&userGroupName=anon%7E4cbd20ce.

[7] "Price of Bitcoin." Coinbase. Accessed April 18, 2022. https://www.coinbase.com/price/bitcoin.

1.2 Criminal use of Cryptocurrencies

Since the creation of Bitcoin, more than 1,000 altcoins and crypto-tokens have been created, with at least 919 trading actively on unregulated or registered exchanges.[8] The fact that the majority of these virtual coins are unregulated, poses a high security alert of illicit activities being pursued through this virtual market. Individuals in this field have found that with the help of cryptocurrencies, they are able to sort of skirt the law and avoid the traditional financial instruments, in that way pursuing their illicit activities through this new trend, with much lower threats of being held liable. Further, the author will implicate the major criminal activities individuals pursue through cryptocurrency, using the anonymity factor as an advantage.

A potential threat of using cryptocurrencies in the widespread, is tax avoidance. The rapidly growing economic importance of cryptocurrencies, such as Bitcoin, facilitates tax fraud & evasion.[9] The EU is on the track of amending a proposal on how to regulate this action. The European Commission will amend the Directive on Administrative Cooperation ('DAC') to ensure that EU rules stay in line with the evolving economy and include other areas such as crypto-assets and e-money in the DAC8 proposal.[10] But how is it actually possible to restrain from abiding the original financial tax system?

With the use of a decentralized market, individuals are able to avoid tax obligations. Posing with a pseudonym, individuals are able to hide their income, and pursue transactions without a record in centralized institution of the funds being transferred of obtained.[11] Since no government or its entity has created this market, they are not able to govern it. Individuals can transfer their funds through the virtual market, without any tax liability imposed. Bitcoin (and other cryptocurrencies) offer one additional major advantage to tax-evaders that traditional tax havens do not: the operation of Bitcoin is not dependent on the existence of financial intermediaries such as banks.[12]This creates a paradigm, where individuals who are looking to save money avoiding taxes, may turn to cryptocurrencies to pursue it. This action imposes a

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[8] "Cryptocurrency: A New Investment Opportunity?" The Journal of Alternative Investments. Last modified December 31, 2017. https://jai.pm-research.com/content/20/3/16/tab-pdf-trialist.

[9] "Crypto-assets and E-money." EU Science Hub. Accessed April 19, 2022. https://joint-research-centre.ec.europa.eu/corporate-tax-policy/crypto-assets-and-e-money_en.

[10] *Ibid*

[11] "Cryptocurrency: The Economics of Money and Selected Policy Issues." Every CRS Report - EveryCRSReport.com. Accessed April 18, 2022. https://www.everycrsreport.com/files/20200409_R45427_8469ceaa641685c78bf188b7e5fdbb23004507a4.pdf.

[12] "are cryptocurrencies super tax havens?" Michigan Law review. Accessed April 18, 2022. https://heinonline.org/HOL/Page?collection=journals&handle=hein.journals/mlro112&id=42&men_tab=srchresults.

high risk on the traditional centralized market, where the tax system has been carefully regulated, so the society is restricted from illegal activities. As mentioned before, every transaction is recorded in the virtual market, but there is no obligation of providing a legal name, which means that the taxes cannot be reported. Whether it's the capital gains from trading cryptocurrencies, or moving the funds to the virtual market, tax avoidance is possible and fairly easy. Cryptocurrencies are being accepted in more and more places, situations and transactions. Every purchase, trade and investment can be done without reporting taxes. Every person can open as many crypto wallets, where the funds are stored, as they want. This means that governments are not really able to restrict the evasion of taxes. Anytime an account gets blocked, the same person can open a new wallet and continue the illicit activities. Since it is anonymous, only the wallet itself is caught, not the person behind it. But is there a way of regulating the virtual market and imposing these restrictions on tax avoidance? The EU has proposed a regulation which may come into force in the near future, where stricter tax regulations will be applied on the cryptocurrency market. Directive on Administrative Cooperation 8 (DAC8) initiative and the related public consultation launched by the EU Commission in March also seek to ensure adequate tax transparency and proper taxation of income generated by investments or payments in crypto-assets and e-money.[13] This proposal has the potential of becoming a good unified basis for the European Union on regulating this new market paradigm. This initiative would ensure consistency as well with ongoing work at EU level in this respect, such as future legislative proposal on anti-money laundering and terrorism financing.[14] As this proposal is still yet to be completely adopted, in the meanwhile, Member states have to take it up by themselves on trying to regulate the illicit activities happening in the new virtual market.

Tax avoidance is not the only illicit activity criminal users tend to pursue through the cryptocurrency market. Money laundering and Terrorist financing has appeared as a high-risk factor in this paradigm. Money laundering by definition is the crime of moving money that has been obtained illegally through banks and other businesses to make it seem as if the money has been obtained legally.[15] In this case, the money is not moved through other banks, but stored in

[13] PricewaterhouseCoopers. "DAC 7 and DAC 8: A New Set of Rules to Expand Reporting Obligations for More Tax Transparency to the Digital Economy and Crypto Environments." PwC. Accessed April 19, 2022. https://www.pwc.lu/en/newsletter/2021/dac-7-dac-8.html.

[14] *Ibid*

[15] "Money Laundering." Cambridge Dictionary | English Dictionary, Translations & Thesaurus. Accessed May 11, 2022. https://dictionary.cambridge.org/dictionary/english/money-laundering.

crypto wallets and distributed through various cryptocurrencies, in that way avoiding any legal liability and making the money seem official.

Criminal users for these activities do not tend to use the major coins such as Bitcoin, Etherium, Litecoin, but refer to smaller and more unknown coins to pursue these actions, since it is harder to trace any type of activity on a low grid coin. It is crucial for these individuals to have full anonymity. To better understand the scale of money laundering threats in the crypto industry, figure 2 is provided.

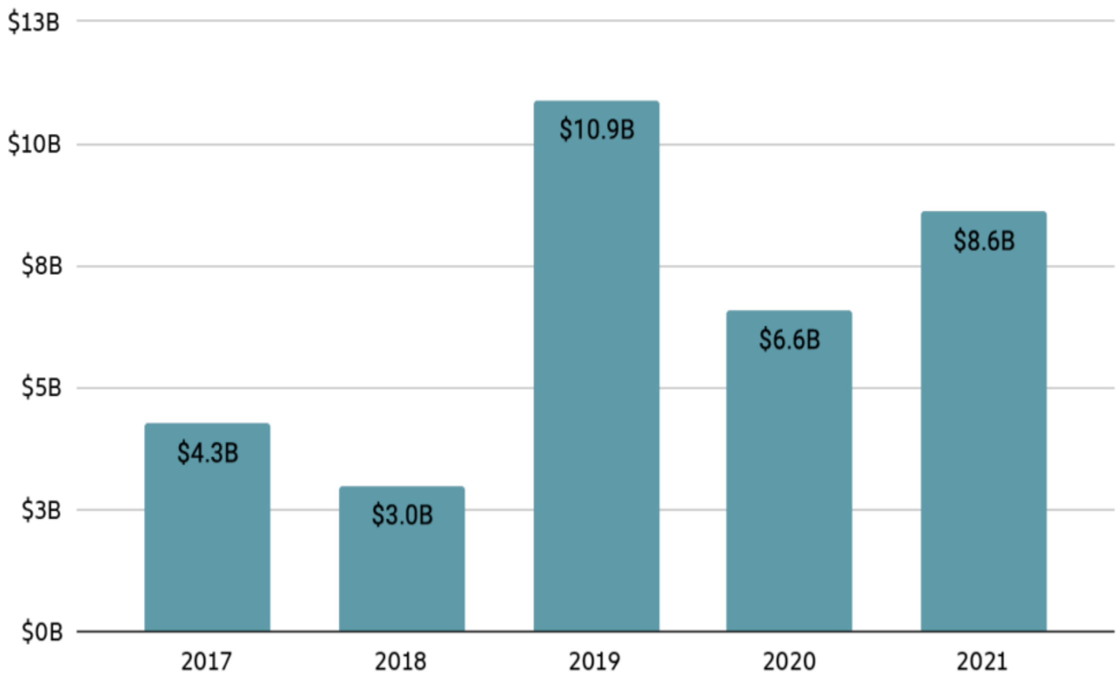

Figure 2. "Total cryptocurrency value laundered by year, 2017-2021"[16]

As the graph indicates, in the past 5 years more than 30 billion US dollars have been laundered through the cryptocurrency market. Understanding, that this still is a new, and frankly undiscovered market by a lot of people, future upwards trend might showcase crucially high threats of money laundering increase if not properly regulated.

Since governments cannot backtrack the data, illicit users are completely free to fund their attacks without any trace back to them or the organization they represent. A solid example of influencing political movements and funding it with crypto assets were seen in the presidential election of the United States in 2016. The Mueller report explains how 12 Russian operatives,

[16] Newar, Brian. "Crypto Money Laundering Up by One-third in 2021 but Still Below Record." Cointelegraph. Accessed May 11, 2022. https://cointelegraph.com/news/crypto-money-laundering-up-by-one-third-in-2021-but-still-below-record.

including two internal units working for the Main Intelligence Directorate (GRU), the foreign military intelligence agency of the Russian Federation, used over $95,000 of bitcoin to purchase virtual private networks (VPNs) and other computer infrastructure to hack computers at the Hillary Rodham Clinton campaign, the Democratic National Committee, and the Democratic Congressional Campaign Committee to obtain and release sensitive documents and thereby influence the results of the 2016 presidential election.[17] Russian operatives likely used cryptocurrency to fund interference in the 2016 U.S. election because of the pseudonymity it offers users and the more limited regulatory enforcement against virtual currency exchanges relative to banks at that time.[18] The process pursued with the help of cryptocurrencies caused a violation of fair and transparent elections of the president of the United States. Majority of people after finding this sensitive information changed their vote from Hillary to Donald Trump, which had a major impact to the final voting number. Russian intelligence operatives succeeded in their 2016 election interference efforts in part because they were able to avoid any direct relationships with heavily regulated and legally compliant financial institutions.[19]

Further, the author will discuss, whether there is any type of correlation between the cryptocurrency market and the traditional financial stock system, to understand, if cryptocurrency has successfully integrated into the financial dynamic, and will it stay highly volatile, or become more predictable over time.

1.3 Cooperation of Cryptocurrencies with traditional Financial Markets

A major reason why specialists advise not to invest large amounts of funds into the cryptocurrency market, is the high volatility rate. Overall, there is nothing grounded that is backing up cryptocurrency markets, no government issued financial instruments are backing up this market – investment's value isn't very grounded, which makes its price incredibly sensitive to even slight changes in investors' expectations or perceptions, it is based on speculations and educated guesswork.[20] Although, in the past years, there has been improvement. Before the

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[17] Rosenberg, Elizabeth, Jesse Spiro, and Sam Dorshimer. Report. Center for a New American Security, p.7 2020. Page 10, Accessed May 4, 2022. http://www.jstor.org/stable/resrep27458.
[18] *Ibid*
[19] I*bid*

[20] "Explaining Crypto's Volatility." Forbes. Accessed April 18, 2022. https://www.forbes.com/sites/nicolelapin/2021/12/23/explaining-cryptos-volatility/?sh=586617507b54.

Covid-19 pandemic the market was extremely volatile, and non-predictable. People mostly just held onto their investments for a potential growth long term, or day traded on a high risk – high reward basis. But in 2020, the cryptocurrency market and the S&P500 stock index showed significant correlation, both extremely surging after the central bank crisis, because of strong investor interest.[21] To better understand the correlation that is building between the cryptocurrency and the stock market a graph is provided.

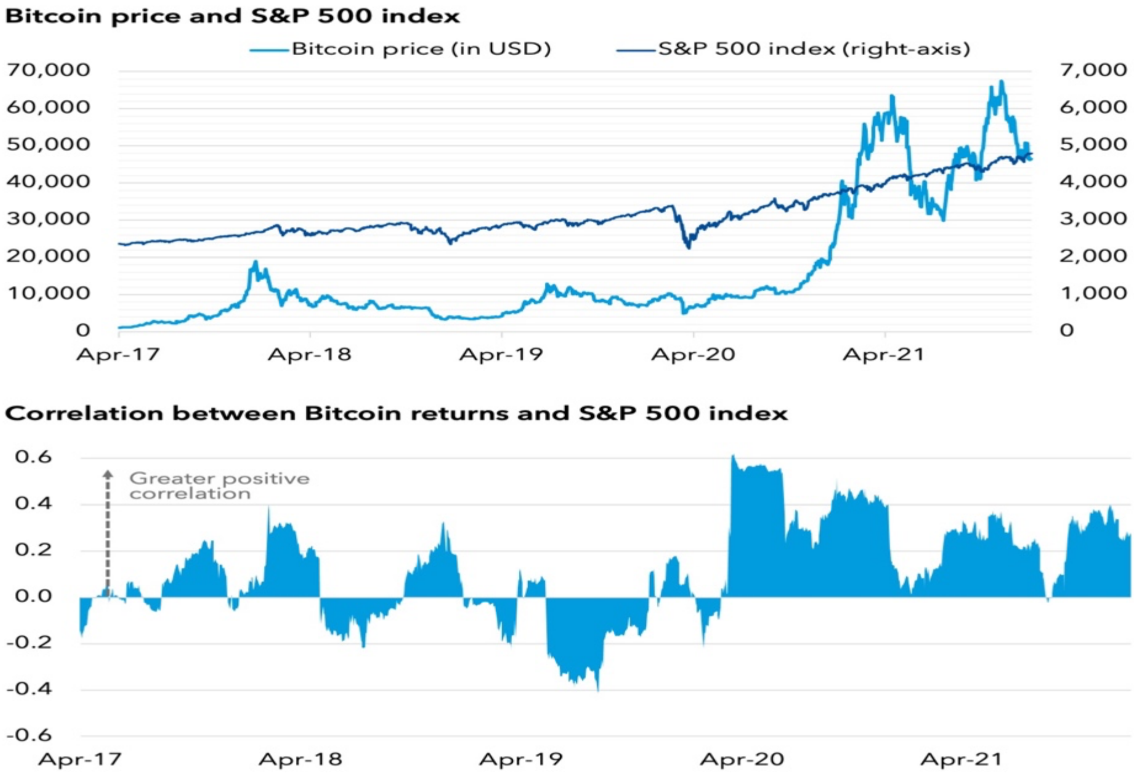

Figure 3. "Stronger correlation"[22]

As the graph indicates, At the end of 2020, a correlation is seen between the two markets, showing evidence of similar upwards pattern and a similar bounce on the trend. As it is a good sign, seeing that the biggest cryptocurrency – Bitcoin is stabilizing and showing volatility similar to the index stock market, it raises significant concerns as well. The increased and sizeable co-movement and spillovers between crypto and equity markets indicate a growing interconnectedness between the two asset classes that permits the transmission of shocks that can destabilize financial markets.[23] The stabilization of the crypto market and indication of correlation with the S&P 500 index market could potentially signal a risk factor of crypto world-wide adoption. If this situation escalates, a comprehensive, coordinated global regulatory

[21] Adrian, Tobias. "Crypto Prices Move More in Sync With Stocks, Posing New Risks." n.d. p.1 https://blogs.imf.org/2022/01/11/crypto-prices-move-more-in-sync-with-stocks-posing-new-risks/.

[22] *Ibid*

[23] *Supra* note 20, Adrian, Tobias. "Crypto Prices Move More in Sync With Stocks, Posing New Risks." n.d. https://blogs.imf.org/2022/01/11/crypto-prices-move-more-in-sync-with-stocks-posing-new-risks/.

framework to guide national regulation and supervision and mitigate the financial stability risks stemming from the crypto ecosystem is crucially needed, as the ignorance of adopting this kind of regulation might crash the original financial system markets as we know, and opening the so called "flood gates" of illicit activities pursued in the cryptocurrency market.[24] A global risk of major tax evasion might occur, if the correlation, integration and merger of crypto market and stock index market is completed. Funds obtained in the stock market may be easily moved to the crypto market, where the transactions stay anonymous, in that way no type of tax reporting is done, and the centralised tax system might crash.

To summarize, a pattern of correlation is seen between the stock market and the new virtual market, which shows positive signs of stabilization in the cryptocurrency industry, but it has to be taken carefully, and a regulatory framework is necessary to avoid the collapse of financial restrictions imposed in the centralized markets.

1.4 Crypto market as a single currency

It is well known that the cryptocurrency market has taken the world by surprise, showing a tremendous amount of growth in a short amount of time. Cryptocurrency enthusiasts, and even specialists in this field have started to speak about the potential of cryptocurrency becoming a single world-wide currency. Getting rid of the traditional financial system and replacing it with a new, technology evolving system, where physical money completely disappears. How realistic is this scenario and what obstacles may come, if this action is pursued, and for example, Bitcoin becomes the single world currency?

To understand, if Bitcoin has the potential to become a single currency around the world, it is needed to understand, why it would be different from other currencies, and what could be the reason behind Bitcoin becoming a single world currency. Unlike any other currencies, such as Euros, Yens or United States dollars, Bitcoin entails three peculiarities: It introduces a separate unit of account, it has no single and identified issuer and its quantity is ultimately fixed once and for all.[25] These are the aspects that make Cryptocurrencies differ from standard currencies. Currencies used around the world have a single issuer, it is governed by a state entity, and it is fully regulated by the Governments. As to cryptocurrency, it sort of

[24] *Ibid*
[25] "Impact of Bitcoin as a World Currency." ResearchGate. Accessed April 21, 2022. https://www.researchgate.net/profile/A-Seetharaman/publication/317134650_Impact_of_Bitcoin_as_a_World_Currency/links/5f27f08f299bf134049c8832/Impact-of-Bitcoin-as-a-World-Currency.pdf.

destroys all of the aspects we have accepted in terms of currency and its system. Bitcoin implies that its quantity cannot be adjusted to variations in demand, and it does not come with anybody's promise to convert it into official currency at a certain rate. [26] As with traditional currencies, they can be changed and they in fact do change constantly. New versions are being printed out, meaning that the currency has to be changed, as it is a physical instrument, it derogates over time and has to be switched. The flow can be manipulated – the money can be printed more or less to help stabilize economy or change the value of the particular currency. As it was seen at the start of Covid-19 crisis, the United States had to highly amplify the printing of Dollars, to help stabilize the situation, but that lead to the US dollar dropping its value. Bitcoin erases all of these possibilities, as there is a certain limit of the coins that can be mined. As it looks like a good opportunity for Bitcoin to become a single currency and erase the financial system as we know it, is it really possible?

One of the reasons why it would not be possible, is Unlike fiat currencies such as the U.S. dollar, bitcoin has proven to be too volatile to make it a reliable vehicle in which to store value over long periods of time.[27] As mentioned before, there is nothing strong and stable backing up the cryptocurrency market. The market shows itself as an unreliable source, even with the tendencies of going in sync with the stock market this year, the market changes too quickly, and the price can sky rocket or drop significantly even in a one day's span. Another reason is security risks. As mentioned before, anonymity of Cryptocurrencies is a two-way street. If Bitcoin would be issued as a single currency, all of the transactions would go through the cryptocurrency market. Since Governments have not yet found a valid solution on breaking the anonymity gap, this could lead to a huge increase in illicit activities. All of the transactions would be made through cryptocurrency, so individuals who were limited on their criminal actions with standard fiat money, would have major opportunities to conduct their strategies and plots through the new system.

To conclude, it is still very early to say whether Bitcoin can become a single currency. The progress and innovation this new system brings shows a potential of substituting original fiat money. But it has a long way to go before it can become viable, efficient, independent, and

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[26] *Ibid*

[27] "Why Bitcoin Is Not a Viable Currency Option." Knowledge@Wharton Network. Accessed April 21, 2022. https://kw.wharton.upenn.edu/kwfellows/files/2018/06/2018-08-30-Bitcoin-Student-Series.pdf.

widely accepted, as it poses major technological hurdles, and its acceptance in society is currently limited at best.[28]

Further, the author will discuss European Union issued documents, and its member state issued nation laws on regulating cryptocurrency market flow and the reduction of illicit activities in the virtual market. Member states with strong and weak regulatory systems on this new paradigm will be analysed, to see the difference between the state systems, and to indicate the need of a unified system, to avoid illicit users in choosing a country where the regulation may be taken for advantage in their particular situations.

2 EUROPEAN UNION MEMBER STATE NATIONAL LAW REGULATIONS ON CRYPTOCURRENCY TRANSACTIONS

2.1 Member States with a strong regulatory system on cryptocurrencies

Malta – The reason for analysing cryptocurrency regulations in Maltese law is because this is the destination for many industries and companies when choosing jurisdiction for their cryptocurrency breakthroughs.[29] Malta Blockchain is providing investment opportunities and incentives allowing it to become the World's first Blockchain Island.[30] Due to the fact that this industry is rapidly developing every day, the government of Malta is being cautious on how to regulate the area without posing any unnecessary restrictions, with the hope that Malta Blockchain will be a global success.[31] In April 2017, the Cabinet of Ministers in Malta approved a National Blockchain Strategy, and in just five months launched a special Blockchain taskforce which has been trusted to review proposals made to the taskforce, as well, as make recommendations to create a clear roadmap for the government to implement in its National Blockchain Strategy.[32] Apart from exploiting the opportunities that blockchain technology offers for added efficiency in public sector processes and services, the Government is ambitiously looking into the setting up of a new regulatory function with the primary objective of harnessing the technology with a legal

[28] "Why Bitcoin Is Not a Viable Currency Option." Knowledge@Wharton Network. Accessed April 21, 2022. https://kw.wharton.upenn.edu/kwfellows/files/2018/06/2018-08-30-Bitcoin-Student-Series.pdf.
[29] "Risks of money laundering regarding cryptocurrency transactions, regulation and functionality" Page 16 Kārlis Plūme, Accessed on April 21, 2022
[30] Cauchi, Maria C. "Malta Blockchain Strategy Revealed." CCMalta. Last modified October 31, 2018. https://www.ccmalta.com/insights/news/malta-blockchain?lang=hu-HU.
[31] Ibid
[32] "PRESS RELEASE BY THE PARLIAMENTARY SECRETARIAT FOR FINANCIAL SERVICES, DIGITAL ECONOMY AND INNOVATION: Government Announces Taskforce Advising on the National Blockchain Strategy." Home. Accessed June 6, 2021. https://www.gov.mt/en/Government/DOI/Press%20Releases/Pages/2017/September/15/PR172070.aspx

operational framework, serving as a bold initiative leading to the formation of an ideal ecosystem for those willing to invest in blockchain technology.[33] Malta's strategy is to impose three types of law to create the sense of lawful transactions and business operations with cryptocurrencies. [34]

Virtual Financial Assets Act: as stated by the Malta Financial Services Authority (further, MFSA), VFA was created to build a framework that supports the innovation and new technologies for financial services in the area of crypto-assets whilst ensuring effective investor protection, financial market integrity and financial stability.[35] The VFA succeeded in creating a test regarding Virtual Instruments. This test is set out to be mandatory with the objective to determine whether a DLT (Distributed ledger technology) asset, based on its specific features, is encompassed under (i) the existing EU legislation and the corresponding national legislation, (ii) the Virtual Financial Assets Act or (iii) is otherwise exempt.[36] Any industries, persons or businesses/ enterprises have to qualify within the bounds of this test to pursue virtual currency action within Malta. As stated by the MFSA, The Test is applicable to (i) issuers offering DLT assets to the public or wishing to admit such DLT assets on a DLT exchange in or from within Malta; and (ii) persons providing any service and/or performing any activity, within the context of either the Virtual Financial Assets Act or traditional financial services legislation, in relation to DLT assets whose classification has not been determined.[37] This act and the test will allow for the Maltese government to ensure safe and legal transactions within the scope of virtual currency market, as well as restrict some type of anonymity with the Financial instrument test. [38]

Digital Innovation Authority Act of Malta: The MDIA Act provides legislation on the regulation of innovative technologies, as well initiates a new base for disclosure between Malta's authorities. As mentioned before, the problem with cryptocurrencies is the fact that it is decentralized and some what anonymous. MDIA act is created to establish a central authority that is eligible to supervise the voluntary certificates imposed of Technology

[33] Ibid
[34] *Supra* Note 28, page 17
[35] "Virtual Financial Assets." MFSA. Last modified August 25, 2020. https://www.mfsa.mt/fintech/virtual-financial-assets/.
[36] *Ibid.*
[37] *Supra* note 34 Virtual Financial Assets." MFSA. Last modified August 25, 2020. https://www.mfsa.mt/fintech/virtual-financial-assets/.

service providers.[39] Part IV point 26. (1) states that the authority has the right to require any information from an applicant for the innovative technology authorisation to grant recognition of to deny it, as-well as to decide whether a service provider can continue to hold any authorisation.[40]

Another country with a strong regulatory system in the cryptocurrency field is Slovenia. It is considered as one of the most Crypto-friendly countries in the EU. The country has the highest market capitalization of blockchain projects per capita.[41] Slovenia has taken a rather original approach to regulating the cryptocurrency market. Currently, Slovenia treats cryptocurrencies as virtual currencies, meaning that, according to the Slovenian Act on Payment Services and Systems, they are neither financial instruments nor monetary assets.[42] This is a god way of dividing cryptocurrencies out of the traditional financial market, as they are not the same, meaning they are decentralized and anonymous. To better restrict illicit activities in this market, all cryptocurrency exchanges and dealers participating in cryptocurrency trades are considered “financial institutions” for purposes of the Anti-Money Laundering Act, which now makes explicit reference to cryptocurrencies.[43] Slovenia has created and amended different requirements and elements on regulating the stream of cryptocurrencies. For taxation purposes, both Corporations and individuals are obliged to report their taxes. Corporations must pay taxes in Slovenia, so long as they have a tax residence in the country, even if they are registered abroad and comply with all the taxation requirements of that country.[44] This is a smart way of potentially reducing the amount of tax fraud in the EU, as it is still possible to avoid paying taxes even under these sorts of regulations, but it could reduce the amount, as even if a person would transfer the money through a different country, if they have a residence in Slovenia, they are still obliged to comply with the tax requirements. For personal actions in the cryptocurrency market, Slovenia’s legislation is slightly different. For individuals, any income obtained in the form of cryptocurrency, such as employment income or profits derived from a “permanent business activity,” is subject to personal income tax, this

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[39] Malta Digital Innovation Authority – Malta Digital Innovation Authority. Accessed June 6, 2021. https://mdia.gov.mt/wp-content/uploads/2018/10/MDIA.pdf.

[40] *Ibid*

[41] "Crypto Industry Regulatory Risks. 2022 Rating by Country • Scalable Solutions." Scalable Solutions. Last modified March 5, 2022. https://scalablesolutions.io/news/industry-reports/crypto-industry-regulatory-risks-2022-rating-by-country/.

[42] "Cryptocurrency Ownership Data for Solvenia 2021." TripleA. Last modified August 5, 2021. https://triple-a.io/crypto-ownership-solvenia/.

[43] "Slovenia and Cryptocurrency." P.1 Freeman Law. Last modified March 10, 2022. https://freemanlaw.com/cryptocurrency/slovenia/.

[44] *Ibid*

includes crypto "mining" as well.[45] But this regulation does not affect trading. Capital gains obtained from trading or fluctuations in the cryptocurrency market are not subject to any income taxation, since cryptocurrencies are not considered financial instruments or shares under Slovenia's Personal Income Tax Act.[46] This gives a positive note of the crypto market users who wish to purely trade in this paradigm. As this market is not a financial instrument, people are free to pursue trading actions without tax reporting or the fear of committing tax fraud.

Overall, several EU member states have pursued a solid National regulatory framework on restricting criminal activities in the cryptocurrency market. Further, the author will discuss the European Union countries with a severely weaker regulatory system, and indicate how this unequal paradox between the countries show significant security risks, as individuals may move their transactions through countries where regulations are more in favour of their actions.

2.2 Member States with a weak regulatory system on cryptocurrencies

As many European Union Member states have indicated a strong national law foundation on regulating cryptocurrency markets, some member states are falling behind with their frameworks. As there is no Unified system on how EU member states have to regulate this new technology, Countries with weaker restrictions possess a threat of illicit users moving their criminal activities through these particular countries.

A prime example of not creating any National Law regulations regarding restricting illicit use of the cryptocurrency market is Greece. In the 7 past years, the population of Greece has indicated a large upscale of interest in the cryptocurrency market, trying to find ways of recovering from the nations' financial problems. The Greeks frantically turned to online trading platforms in search of Bitcoin during the doldrums of debt crisis in 2015, when banks began shutting down and capital controls were put in place.[47] People were desperately trying to find ways and opportunities of good investments, with potential high return. Cryptocurrency market was a platform that gained the interest of Greeks because of the high fluctuations, giving the opportunity of a high risk, high reward concept. The government institutions of Greece were indicated of the high demand and investments being pursued in this new digital market, but chose not to pursue with any National Law regulations. As there is no unified legislation

[45] *Ibid*
[46] "Slovenia and Cryptocurrency." Freeman Law. Last modified March 10, 2022. https://freemanlaw.com/cryptocurrency/slovenia/.
[47] "Greece and Cryptocurrency." Freeman Law. Last modified March 9, 2022. https://freemanlaw.com/cryptocurrency/greece/.

provided by the European Union, as mentioned before, illicit users may take up their actions with countries weakly regulating the cryptocurrency market. In this case, Greece may be a solid option for the purposes of money laundering and tax evasion, as these fields are completely untouched by the centralized organisations. Greece widely accepts cryptocurrencies, especially after their financial crisis in 2015, meaning that the flow of Bitcoin and other virtual currencies is high in this State. Since high value of cryptocurrencies are fluctuating in Greece, criminal users can quite easily blend in the majority of transactions and pursue with their activities without any suspicion by Government Institutions. There is no dedicated tax regime for blockchain or cryptocurrencies, but reminding that the country is recognized and established as an EU member state, Greece has agreed to follow any EU initiatives and to enforce AMLD5.[48] At the given moment, this is the only type of monitoring and to some sort regulation of cryptocurrencies in Greece. The system of restricting criminal activities in the cryptocurrency market is insufficient in Greece, and it leaves a free space for users to pursue with their actions. This situation in a way derogates the efforts of other EU member states and their issued National law regulations. For example, the individuals, who suspect that the Swiss regulatory system is too strict and there is a chance that their actions may be caught and they would become liable for criminal activities, may choose to pursue their actions through Greece, in that way avoiding any type of threat of being exposed.

A similar situation of little to no regulation regarding cryptocurrency market transactions, investments and trades is being pursued in Latvia with its National law restrictions. Latvia's Financial and Capital Market Commission has warned investors that in Latvia there is no regulatory framework for cryptocurrencies.[49] There are no specific regulations or obligations to obtain a license to pursue cryptocurrency transactions in Latvia, for neither companies or private individuals.[50] Since no particular prohibitions exist in the Latvian legislation, a similar problem occurs as in Greece, as individuals are free to pursue with any type of actions they prefer in the cryptocurrency market. Commercial activities related to the purchase and distribution of bitcoins or similar cryptocurrencies are not considered financial instruments or money issuance, nor are they payment services, hence they are also not obligated to be licensed

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[48] Thomson Reuters. "Cryptocurrency regulations by country." Thomson Reuters. Accessed May 6, 2022. https://www.thomsonreuters.com/en-us/posts/wp-content/uploads/sites/20/2022/04/Cryptos-Report-Compendium-2022.pdf.

[49] Thomson Reuters. "Cryptocurrency regulations by country." p.17 Thomson Reuters. Accessed May 6, 2022. https://www.thomsonreuters.com/en-us/posts/wp-content/uploads/sites/20/2022/04/Cryptos-Report-Compendium-2022.pdf.

[50] *Ibid*

with the Commission of Latvia.[51] Latvian government has indicated in fact, that they wish to improve their legislation, as In 2019 Latvia expanded the role of the Financial and Capital Market Commission to cover AML/CTF and impose beneficial ownership requirements on local limited companies, foundations, unions and other enterprises. [52] Latvia is far away from successfully regulating cryptocurrencies and restricting potential criminal activities in this field. Although, National law has no specific regulations regarding crypto markets, Latvia was one of the few European Union member states to sufficiently within the deadline implement the AMLD5 into their legislation. This indicates that Latvia takes the risks quite seriously, implementing EU ground rules, observing that this new market has the potential of depriving citizens of equal rules on financial assets, instruments and monetary values. Although EU imposed directives are being implemented by Latvia, they are still failing to implement any National laws in the meantime, while a unified legislation is being produced.

To summarize, not all European Union member states have successfully implemented National Law regulations to restrict criminal users from using this market for illicit purposes. As a Unified system is not completed by the EU, this creates a sort of a loop hole in the system, allowing user to choose which country regulations better suit their activities, and which countries have the lowest risk of catching criminal users in the crypto market industry. States that have failed to implement any regulations regarding the restriction of criminal access to cryptocurrencies, are derogating the efforts of member states who are actually trying to restrict these actions. As these currencies do not pose any national borders and are untethered, they can be moved virtually and the users are free to avoid taxes, launder money and potentially finance terrorist groups through the countries with the weakest legislation regarding this market. To better develop these restrictions and increase the regulatory frameworks, each member state should prioritise safeguarding this market, while the European Union is generating a plan on unifying this type of legislation.

Further, the author will discuss the European Union Regulatory documents issued regarding the restriction of illicit use of the cryptocurrency market. Potential insufficiencies and so-called loop holes in these documents will be analysed, to understand how the criminal users

[51] *Ibid*
[52] *Ibid*

may take advantage of the fact that the regulatory system is not fully sufficient and is still yet to be completed.

3 European Union regulatory documents on Cryptocurrency negative stream restriction and its potential insufficiencies

3.1 European Union Issued regulations on the cryptocurrency market

Since the popular demand of cryptocurrency transactions taking place in the virtual market, countries around the world are trying to impose regulations the most efficient way they see possible. The European Union is under a large amount of pressure of creating a Unified regulatory system to prevent any type of criminal action being pursued in the cryptocurrency market. As the only way to fight this battle of illicit use of the new technology market, is by imposing stricter measurements in this area.

In 2020, the European Parliament created a proposal on Markets in Crypto-assets, and amending Directive (EU)2019/1937 (MiCA) as a part of the Digital Finance package, a package of measures to further enable and support the potential of digital finance in terms of innovation and competition while mitigating the risks.[53] MiCA has the potential of being the first Unified piece of legislation issuing regulations on cryptocurrency transactions for the European Union Member States. MiCA's main objective is of legal certainty – For crypto-asset markets to develop within the EU, there is a need for a sound legal framework, clearly defining the regulatory treatment of all crypto-assets that are not covered by existing financial services legislation.[54] The MiCA proposal, consisting of 168 pages will be focusing on regulating cryptocurrencies that are currently out of scope of the EU legislation, meaning that assets such as stable coins will be brought in-scope to further regulate its movement in the market and subject them to obligations and strict due diligence requirements.[55] A stablecoin is a digital currency that is pegged to a "stable" reserve asset like the U.S. dollar or gold and they are designed to reduce volatility relative to unpegged cryptocurrencies like Bitcoin.[56] The purpose of creating such a regulatory system is to essentially take of the stress of EU Member States in

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[53] "52020PC0593." EUR-Lex — Access to European Union Law —. Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937Accessed April 20, 2022. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593.

[54] *Ibid*

[55] "MiCA: A Guide to the EU's Proposed Markets in Crypto-Assets Regulation." Sygna. Last modified May 6, 2021. https://www.sygna.io/blog/what-is-mica-markets-in-crypto-assets-eu-regulation-guide/.

[56] "Stablecoin definition." Coinbase . Accessed April 20, 2022. https://www.coinbase.com/learn/crypto-basics/what-is-a-stablecoin.

creating their national frameworks on safeguarding transactions through crypto markets. Since cryptocurrency markets are not able to "passport" the licensing of these transactions in the EU the way it is completed with traditional financial instruments and services, this amendment could potentially create the ability to pursue these actions in the same way as our well-known traditional markets.[57] An accurate date is still yet to be specified, when this amendment could potentially come into force, but some speculations have been made, that it could be no sooner than 2024. This leads to the concern – will the cryptocurrency industry change drastically until 2024?

5AMLD – The European Union has been critically looking into the possibilities of restricting Money laundering and terrorist financing activities using cryptocurrency markets. As it is known, Money laundering prevention and restriction is pursued by the Anti Money Laundering Act and its continuous revisions. Specific mention of the cryptocurrency transaction regulatory system has been introduced in the 5th Anti money Laundering directive (5AMLD). On 19 June 2018 the 5th anti-money laundering Directive (EU2018/843), which amended the 4th anti-money laundering Directive, was published in the Official Journal of the European Union.[58] As the European Union has recognized that the virtual currency market poses threats of potential money laundering and terrorist financing, a 5th revision on the Anti money laundering Act was proposed in order to provide guidelines in restricting this illicit access. The new revision of this directive focuses on limiting the anonymity related to virtual currencies and wallet providers, but also for pre-paid cards.[59] Terrorist groups are able to transfer the funds needed to pursue their actions through this market, avoiding centralized authorities, since there is no obligation in the cryptocurrency market to report any suspicious activity, that is why the competent authorities in the EU should be able to monitor the use of virtual currencies through obliged, centralized entities.[60] As this revision is not only focusing on the restriction of criminal actions through virtual markets, there are several amendments and proposals on other factors of potential threats discussed in the 5th revision of this directive. The European Union is looking at this situation critically, admitting that it will not be possible at

[57] *Supra* note 54. "MiCA: A Guide to the EU's Proposed Markets in Crypto-Assets Regulation." Sygna. Last modified May 6, 2021. https://www.sygna.io/blog/what-is-mica-markets-in-crypto-assets-eu-regulation-guide/.
[58] "Anti-money Laundering and Countering the Financing of Terrorism." European Commission - European Commission. Last modified 3, 2022. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-countering-financing-terrorism_en.

[59] *Ibid*
[60] "32018L0843." EUR-Lex — Access to European Union Law — Choose Your Language. Accessed April 21, 2022. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32018L0843.

this moment to fully tackle the anonymity of virtual markets, as there are alternative ways on pursuing these actions through this new system. To combat the risks related to the anonymity, national Financial Intelligence Units (FIUs) should be able to obtain information allowing them to associate virtual currency addresses to the identity of the owner of virtual currency.[61] The digital era and the conversion to new technologies brings along a certain amount of confusion. Hearing the words “electronic money,” “virtual currency” and others may seem really similar or even the same to people, who have not had prior knowledge or done prior research. The 5th revision of Anti Money Laundering Act, Article 3(18) provides a definition on what are virtual currencies – “virtual currencies” means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically.[62] The author can indicate, that the 5th revision of Anti Money Laundering Act has provided a quite broad definition of virtual currencies. One of the reasoning behind this strategy is to make this revision applicable to as many cryptocurrencies as possible. Falling into the scope of “virtual currencies” creates a much broader regulatory system in this market.

DAC8 – The author shortly touched upon the Directive on Administrative Cooperation in chapter 1.2. Tax avoidance, as previously mentioned is a high-level threat in the European Union when it comes to cryptocurrencies and its initial market. EU has proposed a directive on regulating, potentially restricting the illicit use of cryptocurrencies to commit tax fraud or tax evasion. On march 10, 2021 The Commission launched a consultation to extend the EU Council’s Directive 2011/16/EU (DAC) compliance measures to include taxpayer disclosures on digital financial asset trading (DAC8), specifically crypto-assets and e-money.[63] This additional extension to previous versions will provide the European Union taxation authorities with information to identify taxpayers using alternative forms of cross-border asset exchange and investment, an area with high risks for tax avoidance.[64] It is possible, that with strong implementation of the new revision, tax fraud and evasion may be cut down significantly. As the original monetary system has successfully regulated tax reporting and restricted tax evasion to the minimum, it is essential for legislators to create a similar system for the new technology era – in this case the cryptocurrency market. Crypto-assets and e-money have rapidly evolved over the last few years and represent a significant challenge in today’s regulatory world while

[61] "32018L0843." EUR-Lex — Access to European Union Law — Choose Your Language. Accessed April 21, 2022. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32018L0843.
[62] *Ibid*
[63] "International Tax review." Accessed April 15, 2022. https://www.proquest.com/openview/3729f7d237e01504be447aeffe4cbe8c/1?pq-origsite=gscholar&cbl=30282.
[64] *ibid*

not being properly covered however by existing regulations notably regarding tax, money laundering and terrorist financing rules.[65] DAC8 aims to ensure taxpayer compliance in using crypto-assets and e-money by expanding information exchange requirements under the second iteration of DAC (DAC2), mainly relevant to account sharing from financial institutions.[66] The largest cryptocurrency – Bitcoin has been accepted by many big companies, in that way expanding the opportunities for their customers, when choosing a way to pay for goods and services. As it is a potentially positive actions, because major companies are following modern day trends, and adjusting their markets and products to be available in many different ways, apart from the standard centralized monetary system, this directive may make it significantly more difficult. Starbucks, PayPal and other large multinational companies that allow commercial exchange and investment with digital assets, particularly Bitcoin, could face fiscal reporting obligations in relation to their users' activity.[67] If, potentially this directive is amended, applied and legally binding for all European Union member states, it may cause issues and maybe even potential setbacks for the major companies. They may decide to rescind this opportunity of being able to pay for goods and services with Bitcoin, as it would significantly increase their expenses, when hiring new accounting staff because of the large number of reports that will be mandatory to submit.

Further, the author will discuss and analyse potential insufficiencies, and so called loop-holes in European Union proposed legislation on regulating cryptocurrencies. Possible ways of how illicit users can avoid these regulations, and what gaps the legislators are leaving in their proposals and directives will be analysed to understand to what extent the EU policymakers need to improve to completely restrict criminal activities in this new market.

[65] PricewaterhouseCoopers. "DAC 7 and DAC 8: A New Set of Rules to Expand Reporting Obligations for More Tax Transparency to the Digital Economy and Crypto Environments." PwC. Accessed April 21, 2022. https://www.pwc.lu/en/newsletter/2021/dac-7-dac-8.html.
[66] *Supra* note 62, "International Tax review." Accessed April 15, 2022. https://www.proquest.com/openview/3729f7d237e01504be447aeffe4cbe8c/1?pq-origsite=gscholar&cbl=30282.
[67] *ibid*

3.2 Potential insufficiencies in European Union issued documents regarding Cryptocurrency regulation

The European Union has acknowledged the rise of the cryptocurrency market. Since the rapid development of this new digital market, security and regulation opportunities of this decentralized technology are being investigated to limit and mitigate the use of cryptocurrencies for criminal activities. European Union issued documents in the recent years have been developed and amended to reduce this action. As this is a completely different system from the traditional monetary institutions, the regulations applied to the standard financial structure cannot successfully control illicit activities in the cryptocurrency world. As this is a new technology for the population, potential insufficiencies in crypto market regulations may arise.

One of the key issues in the regulations imposed by the EU, is the failure of getting rid of the anonymity cryptocurrency market possesses. The 5th revision of Anti Money Laundering Directive came into force, and had a specific reference on how states should tackle this principle. The problem with this directive is that majority of EU countries fail to implement it. Under TFEU Article 258 - If the EU country concerned fails to communicate measures that fully transpose the provisions of directives, or doesn't rectify the suspected violation of EU law, the Commission may launch a formal infringement procedure.[68]

The European Commission (EC) has now launched enforcement action against more than half of the EU's Member States for failing to fully transpose the EU Fifth Anti-Money Laundering Directive (5AMLD) into their national law by the 10 January 2020 deadline.[69] Member states are having trouble with implying the registry EU has proposed in the new revision. Exchanges are now considered "obliged entities" and are treated the same as financial institutions for purposes of AML/CFT law, including the responsibility to impose strong IDV and KYC processes.[70] The hope of this new amendment is to try and regulate the cryptocurrency market similarly as traditional financial systems. These cryptocurrency exchanges and virtual wallets must register with the relevant domestic authorities, meaning, they must hand over to Financial Intelligence Units (FIUs), if asked, the names, addresses and other identifying information of those who own virtual currency on their exchanges.[71] The key issue of regarding cryptocurrencies as financial institutions, is the fact that the EU and its member states basically trust, that individuals will fairly and truthfully commit to these regulations. As with standard financial institutions, they

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[68] "Infringement Procedure." European Commission - European Commission. Last modified October 3, 2022. https://ec.europa.eu/info/law/law-making-process/applying-eu-law/infringement-procedure_en.
[69] "Seventeen Countries Fail to Implement EU 5AMLD | STEP." STEP. Accessed April 22, 2022. https://www.step.org/industry-news/seventeen-countries-fail-implement-eu-5amld.
[70] "Struggles with 5AMLD." ComplyAdvantage. Last modified November 17, 2021. https://complyadvantage.com/insights/struggles-with-5amld/.
[71] *Ibid*

are centralized and individuals using it are bound to their requirements because they can be tracked. With the cryptocurrency market, the anonymity and pseudonymity principle is still in place. This Directive amends the regulation, basically only for the people who choose to obey it. If a person does not want to align with these regulations, the opportunities before this Directive stay the same. A person can open and close as many cryptocurrency wallets as he or she prefers. If one wallet is registered as an obliged entity, and all of the requirements are fulfilled, since these actions are anonymous, a person may operate through a different wallet with and continue pursuing illicit activities. For the major companies, who are bound to the new requirements of 5AMLD, also possess an option of avoiding these requirements. They are moving their actions out of the European Union. These more stringent requirements, and the higher costs associated with compliance (or noncompliance, for that matter, as the fines can be steep), have caused many exchanges to move their operations out of the EU.[72] As from one side, it shows initial progress from the European Union in the regulation aspect, this can potentially damage the structure of the Economy. Major companies have to evolve with the trends the modern world provides, to keep their businesses afloat, and to provide the public with the most up to date technologies for goods and services transactions. As this regulation creates a major increase financial spending with the return staying the same, companies choose to avoid it by either moving their company out of the borders of EU, or just completely shutting the company down. It is crucial for the EU to find a balance within this scope to regulate the cryptocurrency market, with minimising the damage done to the economic state.

The author before mentioned the great potential of Markets in Crypto-assets regulation, which has a great basis of being a unified system in restricting illicit access and use of the virtual market. As the cryptocurrency market is a new paradigm, the initial regulation if full of gaps, which if not restricted, imposes a major risk of continuity of criminal use. One of the insufficiencies in the Markets in Crypto-Assets regulation, is the current draft of MiCA heavily favours entities already regulated in the EU over current crypto players and newcomers, which conflicts with the professed aim of being innovation- and competition-friendly.[73] This means, that the MiCA regulation is overlapping with previous proposals and requirements set out by the European Union. The access to crypto-asset markets is highly facilitated for regulated entities through many waiver mechanisms and monopolies.[74] The MiCA regulation basically

[72] "Struggles with 5AMLD." ComplyAdvantage. Last modified November 17, 2021. https://complyadvantage.com/insights/struggles-with-5amld/.
[73] Adan and EU Crypto Initiative. "MiCA Summary of Shortcomings & Improvement Proposals." Accessed April 22, 2022 https://adan.eu/wp-content/uploads/2021-01-11-Adan-EUCI-MiCA-Regulation-Shortcomings-Proposals.pdf.
[74] *Ibid*

oversees the already modulated entities. And as the already regulated mechanisms are known to the system, the individuals wishing to join the EU requirements are having severe problems and obstacles when applying. The process to become authorized is lengthy (up to 6 months for stablecoin issuers), some rules are out of proportion to their stage of development, such as prudential requirements (e.g., up to 2% of e-money tokens issued), the additional compliance costs are significant for smaller financial actors, such as new entrants, due to the costs that they will have to support for their own supervision, and the monopoly granted on issuance of e-money tokens will forcibly become traditional actors, although these initial regimes are supposed to increase innovation and the appliance of new individuals entering the market.[75]

Another problem with the Market in Crypto-Asset regulation is unjustifiable proportionality negligence. The European Union raise the threat of the cryptocurrency market and its values in essence being undermined and harmed with regulations out of proportionality principles. These rules integrated are regulating all of the actors participating and is in a way completely restricting the chance of innovation in the European Union. The rules for CASP's regarding the issuance of crypto-assets and asset-referenced tokens (including e-money tokens) are so stringent that almost none of the existing actors can benefit from them.[76] The MiCA regulation is a great example of observing insufficiencies in legislation when discussing proportionality. The MiCA Agreement states that to ensure the safeguard and correct flow of cryptocurrencies in the European Union, an exemption for crypto-assets issued to qualified investors only shall be amended.[77] The author indicates, that this is an excellent example of a regulation being imposed negatively – meaning that it may to a certain extent restrict the illicit flow of cryptocurrencies, but at the same time impact the crypto market and its progression in the EU. Crypto-assets offered to the public are mainly purchased by retail investors, the biggest financial supporters for crypto-actors, if this opportunity is restricted by the MiCA agreement, the progression of this market may take an enormous down turn and poses a threat of the cryptocurrency market being left untouched by the public in the European Union.[78] The key essence of this market is the fact that every entity, whether private or industrial, is able to pursue transactions and get involved in this paradigm by using it for purposes of their own insights. A regulation of this sort creates a sort of stop for it, as retail investors, who hold of the majority

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[75] *ibid*

[76] Adan and EU Crypto Initiative. "MiCA Summary of Shortcomings & Improvement Proposals." Accessed May 9, 2022. https://adan.eu/wp-content/uploads/2021-01-11-Adan-EUCI-MiCA-Regulation-Shortcomings-Proposals.pdf.

[77] *Supra* note 75, Adan and EU Crypto Initiative. "MiCA Summary of Shortcomings & Improvement Proposals." Accessed May 9, 2022. https://adan.eu/wp-content/uploads/2021-01-11-Adan-EUCI-MiCA-Regulation-Shortcomings-Proposals.pdf.

[78] *Ibid*

of the cryptocurrency flows and development of the market, are forced to quit. The MiCA agreement poses numerous and continuous threats to successful progression of the cryptocurrency market in the EU. It fails to integrate the balance of restricting illicit activities, but at the same time allowing the market to evolve and pursue with new innovations. The agreement establishes an exemption for stablecoin issuance which are higher than 5,000,000 Euros.[79] This clause is completely out of proportion as all of the stablecoins currently being used by the Cryptocurrency market already possess a higher issuance size than five million.[80] This would mean that all of these coins used in the marked would have to be exempted, not used or highly regulated for them to be allowed within the scope of the EU and the posed MiCA agreement.

Overall, The European Union is failing to successfully balance the restrictions of the cryptocurrency market without imposing threats of regression for this new paradigm. Regulations must be tested and removed if it restricts the innovation and development of the market, as the EU highly values the freedom of opportunity and competition. Efforts of deliberating the anonymity principle have failed and need to be reconsidered, analysed and improved. It is unclear yet to say if the European Union will every successfully break the anonymity of users in the crypto world, but for the current time, this paradigm has not been solved.

Further, the author will analyse future perspectives and opportunities on potential improvements in the EU regulation. Future recommendations for developing more sufficient regulations will be analysed to indicate the certain roadmap the European Union should be taking to restrict illicit use of the cryptocurrency market more sufficiently.

4 FUTURE PERSPECTIVES ON SUFFICIENTLY GOVERNING THE CRYPTOCURRENCY MARKET IN THE EU

4.1 Future intentions on regulating the cryptocurrency market

The regulation system in the European Union is moving into the correct way, and already the system is starting to regulate and reduce the number of illicit activities being pursued in the virtual market. Over the past years, the European Union has pursued and strongly

[79] *Supra* note 75, Adan and EU Crypto Initiative. "MiCA Summary of Shortcomings & Improvement Proposals." Accessed May 9, 2022. https://adan.eu/wp-content/uploads/2021-01-11-Adan-EUCI-MiCA-Regulation-Shortcomings-Proposals.pdf.
[80] *Ibid*

progressed in creating restrictions on the use of the cryptocurrency market for the illicit use – tax fraud, money laundering and terrorist financing, and even influence on political intentions and movements. As this is a new and evolving technology, there is still room for improvement. As the perfect scenario would be an implementation of regulation that would completely disrupt the anonymity principle the cryptocurrency market has revealed, leading to many potential security threats and risks, there is still a long way to go in finding the best balance of regulation without disrupting and damaging the economic and political sphere.

When talking about future intentions in the European Union in regulating the virtual currency system, its market and transactions, it is crucial to analyse this aspect with real, not positive scenarios. So the question remains – what is the realistic scenario for the EU and what are the potential steps the legislators need to pursue to positively change and restrict the negative stream of cryptocurrencies? One of the main objectives in the regulatory system of the European Union in the future would be reducing the anonymity principle by imposing a specific ban on such aspects surrounding cryptocurrencies that are aimed at making it impossible to verify their users (e.g. mixing) and criminally sanctioning these aspects.[81] For example, mixing is the purpose of taking a cryptocurrency which might be illegal or considered a threat, and mixing the value of this particular coin with a verified and safe coin, in that way making the value unclear and being able to move the funds through a secure coin without leaving a trace or a risk of being caught with an illegal coin.[82] This is a security threat that possesses a risk of providing "infected" value of another cryptocurrency being brought in the circulation of the official coins. The EU has the potential to restrict this access by registering the funds, and is on the top of their agenda in the near future. A ban of the so called "mixing" would indicate the effectiveness of a unified EU legislation on restricting criminal actions one by one. It would help in providing a safe and legal virtual currency market flow and would restrict the illicit activity by imposing criminal sanctions on individuals pursuing with this way of mixing virtual currencies

Another future intention proposal would be focusing the attention on the cryptocurrency illegal actions. Meaning, The EU should leave blockchain be from a money laundering, terrorist financing and tax evasion perspective and focus on the illicit use cases of cryptocurrencies, as the Blockchain is just technology and can have beneficial effects in a wide array of sectors.[83] The blockchain itself is an innovative technology which develops every day and provides a new

[81] Digital Health Access | Health Education, Information and Consultation. Accessed April 22, 2022. https://www.digitalhealthaccess.com/crypto.pdf.
[82] "The Cryptocurrency Tumblers: Risks, Legality and Oversight by Usman W. Chohan :: SSRN." Search ELibrary :: SSRN. Accessed April 22, 2022. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3080361.
[83] Digital Health Access | Health Education, Information and Consultation. Accessed April 22, 2022. https://www.digitalhealthaccess.com/crypto.pdf.

model in this original field. The focus on restricting access of criminal activities in the crypto industry, in that way putting the major efforts in the right place, and not inappropriately regulating the blockchain just because of the sole fact that cryptocurrency is using this chain. The threat of money laundering, tax fraud and evasion, and many other potential security and welfare risks are being pursued through the crypto market industry. The New revisions of the Anti-Money Laundering Act or a potential edit in the MiCA regulation in the near future might resolve this issue. The EU has previously mentioned this fact and it is possible, that an update in this field might be seen in the next few years.

One of the most important aspects the European Union will focus on, to help the Member States fight this activity, is tax fraud and evasion. This criminal offence is of up most importance, as it is deliberating the original financial instruments and allowing criminal users to transfer their fiat money into the crypto industry and avoiding taxes of their virtual funds. It is clear that traditional anti-tax-evasion mechanisms cannot success- fully address Bitcoin-based tax evasion, as for example, exchange of information agreements are irrelevant, since Bitcoin's operation is not dependent on the existence of a sovereign jurisdiction.[84] The German government has recently suggested taxing Bitcoins as capital assets, meaning that taxpayers would have to report any income when they dispose of Bitcoins in the same way they report income on the disposition of stock, bonds, and other financial assets held for investment.[85] This would be an interesting aspect and a new way of implementing the cryptocurrencies in the general financial systems, applying similar taxation rules for virtual currencies. Although, this type of action would only be possible when it is exchanged for a government regulated currency, and this type of taxation would not regulate transactions between cryptocurrencies themselves, as no established jurisdiction governs it.[86] As it is not fully sufficient, it is a prime example of putting the first steps into building a solid foundation of official taxation regimes in the crypto-asset industry.

Further, the author will discuss opinions stated by cryptocurrency market specialists, on the future of cryptocurrency. Specialist opinions on further development on regulations regarding the virtual market will be analysed and indicated, if it is aligned with the intentions of the EU. Recommendations published by professionals in this field will be mentioned, to

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84 "Are Cryptocurrencies super tax Havens?" University of Michigan Law School Scholarship Repository. Accessed May 12, 2022. https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1001&context=mlr_fi.
85 *Ibid*
86 "Are Cryptocurrencies super tax Havens?" University of Michigan Law School Scholarship Repository. Accessed May 12, 2022. https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1001&context=mlr_fi.

understand what route the EU should supposedly take to overcome this constant fight with illicit activity users in the cryptocurrency market.

4.2 Recommendations on the future of the regulatory system of cryptocurrencies in the European Union

The virtual currency market has provided a new type of transaction possibilities for the population. It has brought an innovation to the digital era and swept the world with a new, decentralized monetary system. This market is yet to overcome many obstacles ahead. Since the regulatory system of the European Union in regards of restricting criminal users of taking advantage of the cryptocurrency industry is a work in progress, and still to be developed, it is crucial to observe what professionals in this field have to say about the future implementations. As their knowledge is at scale much larger, the opinions and recommendations are crucial in developing a sustainable and safe regulatory system to overcome the obstacle of criminal abuse of the virtual market. Many individuals have stated their opinions about the regulatory system and its functionality.

In a study posed by the University of California, Law school of Berkley, Misha Tsukerman has indicated solid recommendations for future regulatory frameworks for institutions. The EU has made significant efforts into regulating the tax evasion paradigm and trying to restrict users from performing tax avoidance through the cryptocurrency market. Although, it is crucial to remember, that there may be no way for the government to force compliance at the individual level as users can have multiple Bitcoin wallets, and thus multiple public key addresses.[87] Although it might be near impossible to fully restrict these actions, through a mix of incentives and disincentives, many users might be convinced to comply.[88] This possible outcome may create a different output and mindset on the cryptocurrency market users, as they will feel more safeguarded and sure, in that way better accepting the new market and creating a form of respect to this new aspect. As an example, the EU may create tax incentives for people who register their public key

[87] Tsukerman, Misha. "The Block Is Hot: A Survey of the State of Bitcoin Regulation and Suggestions for the Future." *Berkeley Technology Law Journal* 30, no. 4 (2015): 1127–70. Accessed on May 9, 2022. https://www.jstor.org/stable/26377750.
[88] *Ibid*

addresses, but at the same time increase the amount and level of punishments for users who pursue their actions to facilitate the commission of a crime.[89] A reasonable balance would be created with implementing this scenario, by offering different benefits to individuals who decide to comply with the regulations posed by institutions, in this case – the European Union. As well, it would indicate the liability and punishment for individuals who continue to commit this crime by using the cryptocurrency market. The fear of being caught and punished with significant legal retributions would be the best way of approaching this situation and showing that the governments are eager to restrict this possibility once and for all. The key issue at hand is the balance. The Institutions have to be careful of imposing these penalties to a certain limit, and not tipping the scale to the other side, where individuals are so feared of breaching a glimpse of regulations, and deciding to not use the crypto market at all. This would, in fact, create a paradigm which stops the development and innovation of the cryptocurrency market, which deliberates the key essence of this whole initiative. As it may be quite a lengthy process and a high-risk action, a balanced implementation of this type of regulation would significantly decrease the number of illicit activities and at the same time promote the confidence of crypto market users, that way popularizing this new payment and transaction system created by a decentralized authority.

A study conducted by Thomas Alcorn, Adam Eagle and Ethan Sherbondy, significant policy recommendations were proposed on how to shape the regulatory framework in a more sufficient way. They have categorized an approach on who should be regulated within this market, and how it could be done. Cryptocurrency miners in particular, should be mostly left unregulated by legislation, since their role in the Bitcoin market is passive and predictable, leaving litlle room for any government interest in their activities besides taxation.[90] Miners in the crypto industry do not pose the biggest threat of illicit activities. They are involved for only one reason, mining the remaining untouched cryptocurrencies. Other than the fact of taxing profitable margins they acquire, no other regulatory framework should be needed. As for stakeholders, the approach should be different. To create a framework for them, the legislative bodies have to carefully inspect and analyse information obtained from them. stakeholders should do their utmost to ensure that policy makers understand Bitcoin's potential as an

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[89] *Ibid*
[90] Thomas Alcorn, MIT, Adam Eagle, MIT Ethan Sherbondy, MIT. "Legitimizing Bitcoin: Policy Recommendations." Research | MIT CSAIL pp. 14-15. Accessed May 12, 2022. https://groups.csail.mit.edu/mac/classes/6.805/student-papers/fall13-papers/bitcoin.pdf.

evolving currency technology, so that any legal framework leaves sufficient space for future innovation.[91] It indicates correlation with abovementioned recommendations. To issue a sufficient and fully functioning regulatory system for stakeholders and traders, there has to be a careful balance between the restrictions and the opportunities for innovative projects and actions. Deliberating the innovation aspect, the crypto industry is depriving the chance future development in this industry, leaving stakeholders with no choice but to find other projects to invest their time and resources on.

To summarize, The European Union has to take careful steps into further regulating the cryptocurrency market. The issued proposals and directives up to this stage are not sufficiently fulfilling the obligations necessary for a fully transparent market initiative. Balancing regulations and at the same time allowing users to continue evolving this system is the most sufficient way at this stage in keeping the market alive, and at the same time applying different methods in regulating the illicit activities being conducted within this system.

Further, the author will conclude the findings in this research and analyse, how the posed research question was answered. Analysis of whether the hypothesis issued before the research was positive will be analysed, to better indicate and understand the results of the research.

CONCLUSIONS

The cryptocurrency market took the world by surprise in 2009 by providing the society with a new possibility of pursuing transactions through a decentralized, anonymous market. As it gave the society major new opportunities of investments, trading or just a purpose of acquiring goods and services through a new market, it implemented several risks and threats of illicit activities, forcing governmental institutions to react. The cryptocurrency market is a decentralized, anonymous digital market providing currencies not issued by any state or institution. The anonymity factor provides the opportunity of users becoming unknown for any authorities, leaving room for individuals to take advantage of this opportunity and pursue criminal actions through this new mechanism.

The first conclusion after pursuing this research the author indicates the continuous threat of criminal behaviour in the cryptocurrency market. This new digital market system has given the opportunity of individuals to take advantage of cryptocurrencies and pursue illicit

[91] *Supra* note 90. pp. 15

activities in whatever way they seem fit. From money laundering, tax avoidance to even financing terrorism groups. As figure 2 indicated, more than 30 billion US dollars have been laundered through the cryptocurrency market in the past 5 years. The fact that no government has issued and created this market allows for individuals to expand their illegal opportunities and avoid any type of liability in front of governmental institutions and its legislation.

The second conclusion posed by the author is the major differences in EU member state law regarding cryptocurrency transactions. After analysing several European Union Member State laws and regulations issued regarding cryptocurrency trading, transactions and investment opportunities, the author can conclude that the regulatory system highly differs from each member state. Countries as Malta and Slovenia pose a strict guidance for transactions in the cryptocurrency industry and have strictly regulated crypto assets in their national legislation. On the other hand, countries like Greece and Latvia have not posed any national regulations in this regard, and have only relied on directives issued by the European Commission. As each State is free to create their regulatory frameworks in any way they seem appropriate and necessary, the high deviance between them cause risks for all of the member states. If one country decides to pose strict restrictions regarding this matter, individuals wishing to pursue criminal activities through this market may use countries like Latvia and Greece as their so called "scape goats," meaning, they can choose countries with weak, or no regulations at all and pursue their actions there, as the crypto industry poses no physical borders. The lack of legislature created by other states deliberated the efforts of countries trying to regulate and create fairness in this digital system.

The third conclusion made by the author is the significant insufficiencies found in regulatory frameworks issued by the European Union regarding the restriction of illicit use of the cryptocurrency market. The amendment of the 5th revision of the Anti-Money Laundering Act has resulted in a failure. Only 5 countries of the EU have successfully implemented the 5AMLD into their legislation within the given deadline. The European Commission has issued official investigations against the States failing to do so, but the matter is not with the deadline, but with the directive in its essence. The MiCA agreement also has indicated insufficiencies in its core. It has based its main regulations onto entities which have already been regulated. It poses unproportioned restrictions and is threatening to stop the innovation process highly valued by the European Union.

The fourth conclusion indicated by the author is the failure of breaking the anonymity of crypto users. The European Union is simply helpless in this aspect. It has posed regulations that individuals should register their wallets, but there is no proof of actual enforcement. The European Commission is not able to enforce such a law onto an authority which is decentralized. Individuals are able to not register their wallets and pursue their actions, because the fact is, they can hide behind the anonymity principle. Even if these individuals decided to register a crypto wallet, they are free to create as many virtual wallets as they please. As one wallet may seem licensed and fully regulated, another may be opened to pursue illicit activities through.

The fifth conclusion proposed by the author, is the fact that the EU has failed up until this point to create a Unified legislation fully regulating the cryptocurrency market. As they have made progress into the right direction, it is still far away from a fully functioning legislation. The hard truth the legislative bodies need understand is, that it is nearly impossible to fully govern this system, because of the fact that no official authority created it. Breaking the anonymity principle is a constant battle that, without new innovations, will not be possible. The mechanism is based on the individuals joining the market, every transaction is in fact recorded, but hidden behind an anonymous or pseudonymous individual. It is crucial to take steps into the right direction, but any type of fast-tracked regulations will cripple the market and force the users to stop the innovative use of this market. EU has to find a balance between regulatory frameworks and the allowance of development in this market.

The sixth conclusion indicated by the author states that future adjustments might create a more sufficient regulatory system within the European Union. As it may be nearly impossible to fully govern this market, in the near future the EU is able to give an incentive to the individuals using this system to comply with the posed regulations. By creating more opportunities for individuals with registered wallets and licences the European Union may be able to store more confidence in the regulatory system. By applying harsher penalties to those violating restrictions in the crypto asset industry, the legislative body is able to indicate risks of pursuing illegal actions, and at the same time instigate some sort of fear into criminal individuals, in that way lowering the number of illicit users. Finding a balance between these two paradigms might be difficult, but it is a much more realistic approach into fighting this ongoing battle in the cryptocurrency industry.

Seventh conclusion - The answer to the initial research question proposed is negative. The EU has failed to create a unified regulation for its Member States regarding the cryptocurrency market. It has made initial progress into reducing the number of illicit users in this field, but it has failed to successfully eliminate illicit use of the cryptocurrency market, and is still far away from a functional, unified regulation across the member states.

Eight Conclusion proposed by the author concerns the hypothesis implied. The initial hypothesis indicated has been proved positive. The European Union is not able to create a unified legislation to safeguard and regulate illicit activities in the cryptocurrency market. The regulations posed at current stage do not meet the requirements of a transparent, unified and sufficient legislation across the European Union.

To summarize, the European Union is not able to fully govern and regulate the cryptocurrency market at this time. The anonymity cryptocurrencies pose is a high threat but at the current time impossible to break. A unified legislation across the European member states is crucial at this time, but the European Commission is not able to propose directives fully governing the cryptocurrency market. Implementing recommendations indicated in this research the European Union can take potential steps in evolving the regulatory framework and safeguarding transactions pursued in this system.

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