Are Cryptocurrencies and/or Binary Options Enhancing the Risk of Disruption in the Lottery and Gambling Sector?

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On 16 July 2015, Advocate-General Kokott published her Opinion in the first ever European case dealing with the well-known cryptocurrency "Bitcoin." The role of the Advocate-General in European Court cases is to provide the judges with an independent legal opinion based upon an in-depth analysis of the legal questions involved and the written and oral arguments submitted by the Parties, the Member states of the EU, and the EU Commission. Although such opinion is not binding to the judges, we note that the Court does follow its Advocate-General in the majority of the cases. The Opinion relates to the case of Skatteverket v David Hedqvist (C-264/14)[1] which evaluates the legality and treatment of cryptocurrencies from a VAT (Value-Added-Tax) angle. The concern is that these alternative currencies enable a shadow economy in which consumers could play games-of-chance on websites that are neither regulated nor taxed.

Cryptocurrency can be defined as a form of digital or virtual currency, with the distinguishing characteristic that it has been created and then put on the market based on people solving complex computing algorithms or mathematical dilemmas with their own computing system; and in ways that are not controlled by a central bank. Bitcoins are simply a type of cryptocurrency. Being neither taxed nor subject to the regulatory oversight of currencies controlled by any central banking system means that the Bitcoin economy and Bitcoin transactions are not legal currency in the strict sense.

This case assesses the qualification of Bitcoins within the scope of the European Directive of 28 November 2006 on the common system of value added tax ("the Directive").[2] The facts of this case relate to the opening of a website whereby Mr Hedqvist would exchange Bitcoins against fiat currency (i.e. legitimate currencies, in this case Swedish krona) and vice-versa. The question is whether such an exchange operation qualifies as the "supply of services" under the Directive (see Article 2 (1)) and hence to its provisions and requirements. Should the Court answer in the affirmative to that question, it would have to then determine whether such an activity could benefit from one of the exemptions enshrined in Article 135 (1) of the Directive, the so-called legal currency exemption.

The particularities of this case lie in the fact that Bitcoins are considered nowhere in Europe to be a fiat currency or a regulated method of payment. In spite of that fact, Bitcoins are accepted by many websites as payment for the purchase of products and services, or to otherwise participate in economic activities. Few gaming websites allow players to engage their stakes in Bitcoins or other cryptocurrencies.

Advocate-General Kokott first reminds that the Court of Justice of the EU (hereafter: CJEU) found that the taxable activity does constitute the exchange of currency per se and not the transfer of money in itself.[3] Advocate-General Kokott clarifies the situation even further as it specifically states that: "What applies to legal/regulated means of payment should also apply to other means used only in a strict payment purpose. Even though those payment means were not falling under any obligations to be monitored or ensured, they fulfill, from a Value Added Tax (hereafter VAT) perspective, the same functions as any other regulated payment instruments and should therefore be subject to the same treatment, in compliance with the

1 Opinion of Advocate-General Kokott of 16 July 2015, C-264/14, not published so far but available on the internet at http://eur-lex.europa.eu/legal-content/FR/TXT/?qid=1440252381535&uri=CELEX:62014CC0264

2 Directive 2006/112/EC.

3 CJEU, First National Bank of Chicago, C-172/96, EU:C:1998:354.

4 Par. 15 (Free translation from French – Text not available in English).

principle of fiscal neutrality."[4] Since the referring court found that Bitcoins qualify as pure payment means and given the case law of the CJEU on the definition of exchange activities, Advocate-General Kokott believes the operation contemplated by Mr Hedqvist is to be qualified as a "supply of services" in the meaning of the Directive and hence subject to VAT.

However, the second question relates to possible VAT exemption applicable to this type of activity. In that aspect, according to the Advocate-General, the exemption of VAT that applies to "transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest" (Article 135 (1) (e) of the Directive) applies as well to the activity at hand regardless of the fact the exchange occurs between a fiat/regulated currency and a crypto/unregulated means of payment as long as the latter meets the objective assigned to that exemption, namely: the free movement of capital. Indeed, applying VAT to this type of transaction would prevent, or at least curb, the full achievement of that objective, being one of the four EU freedoms. His opinion has far reaching consequences. It actually means that he believes that Bitcoins can be legally exchanged against regulated currencies and benefit from the same rules as exchanging regulated currencies against each other. This Advocate-General Opinion provides from a value added tax perspective Bitcoins with a legal status comparable to regulated currencies.

Of course, this only reflects the Opinion of Advocate-General Kokott, and does not prejudge any final judgment of the Court. However, one can already state that it appears the regulated/unregulated aspect of a currency does not seem to be sufficient to apply distinct treatments between currencies from a VAT perspective. Should the Court rule in favor of the Opinion outlined above, this could represent the first step toward assimilation between crypto and fiat currencies.

To rephrase the above, and in a more general context, such a judgment would be the first step adopted by an EU institution to "define/qualify" Bitcoins from an EU law perspective accepting an equivalence of treatment between fiat and unregulated currencies. This could pave the way to a prospective general allowance or treatment of Bitcoins as a usual mean of payment for different activities (including online gambling) without paying a specific attention to the risks inherent to cryptocurrencies, such as value volatility, systems failure, hacking, and the lack of institutional controls. Lotteries and regulators should monitor these developments. The Advocate General opinion learns us that Bitcoins can be considered as "consideration" in a gambling activity, and by extension any other contribution. This is useful to avoid that bitcoins are used to circumvent the application of gambling laws.

Another topic that should be addressed by national legislative authorities is the proper regulation of binary options. Binary options could be defined as the speculation on the short term movement in price of a stock, commodity, currency, index, or just about anything that is capable of being measured in financial terms.[5] Binary options thus allow people to bet, for instance, on the short term increase or decrease of the rate of a specific share or stock.

Many of the EU Member States currently regard binary options as instruments falling under the general EU legislation applicable to financial instruments (inter alia, MiFID Directives[6]).

While binary options are currently classified in the UK as gambling activities falling under the powers of the Gambling Commission, the UK government is working to cover those activities under the Financial regulations, as also Cyprus already did. Moreover, while the new 2014 UK gambling licensing regime requires operators who intend to provide online gambling activities to UK residents to obtain a remote gambling license from the Gambling Commission, this requirement has not been extended to binary options operators pending the outcome and future decisions of the UK government. Finally, in the Netherlands, both the Gambling Regulatory Authority ("Kansspelautoriteit") and the Financial Market Authority ("AFM") must come to an agreement to settle the question about the competence in relation to binary options. In a recent case, the AFM refused to grant an authorization to a binary options operator since it considered such activities had to be regarded as gambling falling under the supervision of the Kansspelautoriteit. This question remains, nevertheless, legally unsettled. This issue has even been the subject of a parliamentary question to the European Commission.[7] This question outlines the situation in the Netherlands and the fact the EU Directives applicable to legislative instruments do however regard binary options as financial instruments. The Parliamentarian finally sought information about the plan of the European Commission in relation to that issue (i.e. restricting the offering to financial professional investors or following the AFM and treating binary options as hidden betting activities). The Commission expressly replied that binary options have to be regarded as financial instruments provided that they meet the conditions set out in the applicable Directives.

However, no one can deny the similarities between "usual" betting and binary options. Betting could be defined as "any wagering of a stake of monetary value in the expectation of

a prize of monetary value, subject to a future and uncertain occurrence."[8] In light of this definition, it can be argued that binary options are nothing but a type of betting activity. Instead of betting on the outcome of a game, on the weather, on the outcome of an election etc. one bets on the price of a share quoted on the market. Nevertheless, under the current EU legislative framework, the operators of such activities are subject to distinct legal obligations that are different from those applying to Lotteries and legal gambling operators. This consequently enables binary options companies to obtain a license in one jurisdiction and that one license authorizes them to be active in different EU Member States.

What has been described above represents only a few of the issues that could threaten to undermine and disrupt Lotteries in the future. Be it in the form of the provision of veiled gambling activities that benefit from imposing an EU-wide regulatory approach, or from the "bit by bit" recognition, assimilation, definition and regulation of new payment instruments that would be highly disruptive to State Lotteries (and leave the consumer vulnerable to unregulated and aggressive promotional offers and methods that would be to the detriment of the principles of player protection, the fight against criminality and the curb of gambling addiction). What happens in Europe, or anywhere else in the world, can have an impact in every jurisdiction. Strenghtening the transatlantic dialogue, exchange of knowledge and information, and cooperation (as it successfully happened with the ".Lotto"—Generic Top Level domain name issue) may help Lotteries to overcome the future threats caused by innovation that would have a negative and disruptive impact on Lottery and Society. ■

5 Definition given by the UK Financial Conduct Authority, see https://www.fca.org.uk/news/statements/binary-options--potential-changes-in-regulation-

6 Directive 2004/39/CE and Directive 2014/65/CE.

7 See Parliamentary Question of MEP Paul Tang of 30 January 2015, E-001570-15, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fTEXT%2bWQ%2bE-2015-001570%2b0%2bDOC%2bXML%2bV0%2f%2fEN&language=EN

8 Definition drawn from Article 3 of the Council of Europe's Convention on the Manipulation of Sports Competitions.