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Legal regulation of cryptocurrency in the Russian Federation

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Abstract

The research is connected with tackling the issue of the expediency of giving the legal status to cryptocurrency as an alternative monetary system. Thorough research has been given to foreign experience and legal precedents with use of comparative-legal and sociological methodology. As a conclusion, using an alternative monetary system requires a balanced approach. When blockchain technology has become widely spread all over the world, the participants of the virtual money turnover should deal with each other on the legal basis. It calls for the working out of basic concepts and categories with regard to the use of virtual monetary units.

Key words: monetary, currency, cryptocurrency, bitcoin, legal.

Regulación legal de la criptomoneda en la Federación Rusa

Resumen

La investigación está relacionada con abordar la cuestión de la conveniencia de otorgar el estatus legal a la criptomoneda como un sistema monetario alternativo. Se han realizado investigaciones exhaustivas sobre la experiencia extranjera y los precedentes legales con el uso de una metodología comparativa legal y sociológica. Como conclusión, usar un sistema monetario alternativo requiere un enfoque equilibrado. Cuando la tecnología blockchain se ha extendido ampliamente por todo el mundo, los participantes de la rotación de dinero virtual deberían tratarse sobre la base legal. Requiere la elaboración de conceptos básicos y categorías con respecto al uso de unidades monetarias virtuales.

Palabras clave: monetaria, monetaria, criptomoneda, bitcoin, legal.

1. INTRODUCTION

The economic turnover of Russia has changed greatly in the last decade with the use of computer technology to its full extent. We witness the appearance of an alternative monetary system – a digital one. Virtual electronic monetary units such as bitcoins have become widely spread and are used not only for the investment of available cash but for payment as well. The legitimacy of their use has been repeatedly discussed by the governmental authorities as well as The Bank of Russia. As far back as in 2014 the Interdepartmental task force

on crime prevention in economy tried to work out one approach to defining the legal status of cryptocurrency (URL:<https://genproc.gov.ru/smi/news/news-86432/>., 2017). The issues under discussion now are measures to prevent the violation of property rights of citizens and companies and the improvement of legal framework to protect their rights when using cryptocurrency. Nowadays, though cryptocurrency is becoming widely used, the necessity and expediency of its use are points of discussion. What type of money does virtual electronic money belong to? What is its legal nature? Is it legal to use cryptocurrency? What is the legal background that specifies the status of its holder?

2. RESEARCH

1. The analysis of the Russian legislation makes it possible to define the legitimacy of cryptocurrency use. By force of the law prevailing in our country the national monetary unit and its name are stipulated by the Constitution. Today Section 1 Article 75 of the Constitution of the Russian Federation has named the rouble as the national currency, the issue of which is carried out by the Central Bank of the Russian Federation. Moreover, the rouble is an exclusive national monetary unit in the Russian Federation. The introduction and issue of other monetary units as well as the issue of quasi-money by any people regardless of

their status, is banned. The Federal Law on the Central Bank of the Russian Federation (Bank of Russia) No. 86-FZ of July 10, 2002 stipulates that the rouble is an exclusive official national monetary unit (currency). By virtue of the law the rouble is a unified official means of payment accepted by all the participants of the civil commerce (Article 140 of the Civil Code of the Russian Federation). The Civil Code stipulates that in the pecuniary obligation it shall be liable to the payment in roubles or in the amount, equivalent to the definite amount in the foreign currency, or in the agreed monetary units (Section 1 Articles 140, 317). Currency transactions are carried out on terms stipulated by The Federal Law on the Currency Regulation and the Currency Control No.173-FZ of December 10, 2003. Article 141 of the Civil Code as an exception recognizes nonmonetary units, the currency valuables (gems, precious metals), as a means of payment (Oblachinskiy, 2014).

The purpose of making the rouble a legal monetary unit and legal means of payment is to protect the turnover of money from illegal monetary units and money surrogates. The legal status of the rouble is provided by the national currency system, which can guarantee a stable economic development of the country. As the principal element of such a system, the rouble is legally protected by the state. Governmental protection is guaranteed to other monetary and non-monetary units in case their exclusive mode of use is stipulated by the law. In accordance with the law,

a monetary unit as a means of payment can have a real-valued or electronic form. The use of virtual electronic monetary units is not regulated by the law(Ivanchak, 2013).

2. Cryptocurrency is usually understood as electronic money, which, unlike fiat money, is not tangible.¹ It is emitted via the Internet and is not linked with any common currency. The unit of this currency is a coin. It is different from other electronic money in the way additional units are produced and transactions are secured. Cryptocurrency's characteristic features are blockchain - a list of records, and cryptocoins - a set of encrypted data. The codes cannot be duplicated which makes cryptocurrency secure. Cryptocurrency uses decentralized control and is stored in the "wallets" of millions of users all over the world. Cryptocurrency has its advantages and disadvantages. The advantages are:

3. Getting a code: It allows anyone to earn virtual money. Though the process is rather complicated, this is the way many people still earn their living.

4. Anonymity: Unlike traditional electronic money, the transactions with which can be easily tracked, cryptocurrency

¹Crypt – an underground room or vault, a location for secret meetings; cryptos (Greek) – secret. Cryptocurrency is a digital currency that uses cryptography to control the creation of additional units and transactions. Fiat (Latin) – a decree, sanction. Fiat money is money established by government regulation as a legal tender. Nowadays most paper money is fiat, including the US dollar, its value is guaranteed by the authority of a state. Fiat money is not gold-backed and not related to the value of any physical quantity.

does not reveal any information on the owner's wallet except the number of the wallet and limited data on the current balance.

5. Decentralization. Cryptocurrency is an independent monetary unit, no one controls its issue and account activity, and it attracts many net members.

6. Limited issue: The supply of cryptocurrency is limited, thus the risks of inflation due to an issuer's excessive activity are eliminated.

7. Security: Cryptocurrency cannot be hacked, duplicated or likewise manipulated because it is reliably secured.

While remembering the main advantages, we also should cover the main disadvantages:

1) Threat of loss. An access to electronic money is given by a special password. In case of its loss, all the cryptocurrencies in the wallet become unobtainable.

2) Lack of guarantee. Every user bears responsibility for their savings. As there is no regulation of cryptocurrency, in case of a theft it is difficult to prove something or get the money back.

3) Volatility. Cryptocurrency is unpredictable as it depends on the current demand, which in its turn is a subject to change due to changes in legislation, opinions and other factors. That can lead to the fluctuation of virtual money value.

4) Risk of ban. Governmental authorities are careful with cryptocurrency. Many countries have restricted its use, perpetrators can be fined or prosecuted.

We believe that all the above mentioned advantages are outweighed by the main threat of using cryptocurrency, namely, there is no legal base for such transactions, they are conducted at the participants' own risk, websites where such transactions are carried out are not legalized. Moreover, authoritatively it was announced that cryptocurrency was used for conducting transactions and financing criminal organizations (Sentence passed by Moscow district court of the city of Ryazan, 2013). The Russian Central Bank warned against speculative use of virtual currency, stating that "the provision by Russian legal entities of any services on the exchange of "virtual currencies" to roubles and foreign currencies as well as goods (works, services) shall be regarded as potential involvement in illegal activity such as the legalization (laundering) of criminal gains and financing terrorism" (Khabrieva, 2015: 23).

However, the official position of the state on cryptocurrency is not clear. There is no shared vision on the legal nature of

cryptocurrency as a unit of account and alternative currency, no conceptual framework to name the main features of this system. Considering the above-mentioned facts, it is clear why some cryptocurrencies are regarded as money surrogates, which are banned in Russia. Initially it was a prevailing opinion. For instance, in 2015 Nevyanski city court of Sverdlovsk oblast banned seven websites containing information about bitcoin.

The court made a conclusion that cryptocurrencies, including bitcoin, are money surrogates that aggravate shadow economy and cannot be used by citizens and legal entities on the territory of Russia. It should be mentioned that the court judgment (as well as the information notice of the Central Bank of the Russian Federation on January 27, 2014) is based on Article 27 of the Federal law on the Central Bank of the Russian Federation (Bank of Russia), which prohibits the issue of money surrogates. In a similar vein the Ministry of Finance of the Russian Federation drafted bills which banned cryptocurrencies on the territory of Russia and implemented administrative and criminal penalty for breaking this ban. But in the very same 2016 the attitude of the state took a twist. The bills were to be revised and the Federal Tax Service of the Russian Federation announced that the legislation of the Russian Federation does not forbid Russian citizens and entities to use cryptocurrency while conducting transactions. In that context, the purchase and sale of such currency are regarded as currency transactions, subject to the Federal law on December 10, 2003 No. 173-FZ On currency regulation and

currency control. On August 30, 2017 Herman Klimenko, the chief internet advisor to Russian President Vladimir Putin, announced the necessity to create the Russian Association of Blockchain and Cryptocurrency (RABIK), which is aimed at the promotion of blockchain technologies and legalization of electronic currencies. At the same time the Ministry of Finance offered to control cryptocurrency as a financial asset which can be purchased and sold only by qualified investors.

The question now arises of whether the state is ready to legalize cryptocurrency in rough conditions when this type of payment is used in illegal transactions. What measures should be taken, including by the academic community, to protect Russian citizens and Russian businesses from currency machinations?

The Federal Tax Service indicates that the legislation of the Russian Federation does not directly ban cryptocurrency transactions. But it does not legally define such notions as “cryptocurrency”, “virtual currency”, “money surrogate” etc., which would help to define the status of virtual money in the monetary system of Russia. Regarding cryptocurrency as currency valuables appears to be erroneous because, in the first place, its use is not a political will codified by law, but the will of some participants of the civil commerce.

Nowadays, when tackling taxation issues, the decision can be based on the ruling of the European Court of Justice (ECJ) that included in the tax base currency and other means of payment which are not legal tender but are used as such by transaction parties. More specifically, ECJ after studying the legal base of bitcoin, ruled that in value-added tax transactions bitcoin should be treated not as goods/services but as a tender (Skatteverket and Hedqvist). A special consideration should be given to the nomenclature used in the current system of money turnover. The necessity to comprehend modern processes and phenomena make it clear that clarification of definitions used now and the introduction of new ones will help to reflect the subject of research properly. Such definitions must sum up and reflect the full range of specific features of current phenomena. At this point theoreticians and practitioners have heated discussions on the legal nature of cryptocurrency. It is wise to use foreign experience, as international integration influences national legal systems, amongst other things by borrowing legal frameworks and decisions. Thus, any legal system contains elements characteristic to foreign legal experience. This borrowing is by all means advantageous and contributes to unification of legal regulation (Vlasov, 2003).

Mention should be made of the fact that the scope of opinions on cryptocurrency is quite wide. For example, the Federal Tax Service of the US treats bitcoin as property. For Canadian Tax Agency bitcoin is valuable property (profit gained in transactions is considered as profit from commercial activity). Tax Service of Israel treats virtual

currency as a digital unit with the nominal value (Tax treatment of crypto-currencies in Australia). Japan leading in the amount of issued electronic money and electronic money transactions Kochergin (2017) separated cryptocurrency from issuer's electronic money, declared cryptocurrency as equivalent to property value which can be used as a tender. Tax authorities of Finland treat bitcoin as raw material and those of Singapore that has a world lead in the amount of electronic money used in non-cash payment treat it as property.

The Ministry of Finance of the German Federal Republic granted bitcoin the status of private money because it allows to transfer bitcoins to any individual. The Bank of France warns against treating bitcoin as currency and legal tender as there is the possibility to refuse to use it as a means of payment for goods and services and there is no legal guarantee to compensate its nominal value. There is no shared vision on using cryptocurrency as means of payment. In Australia bitcoin transactions are considered equivalent to barter transactions; in Singapore – to software sale or music, etc. Most countries do not legally control the use of cryptocurrency. However, some governments officially announced their point of view on this issue, though predominantly with regard to taxation. Canada appeared to be the most favorably disposed to cryptocurrency country and announced its plans to use bitcoin ATMs to exchange Canadian dollars to bitcoins. In Japan bitcoins are treated as fiat money. The Cabinet ruled to work out a regulatory framework integrating cryptocurrency and the banking system of Japan. In June 2015, the New York State Department of

Financial Services released the long-awaited Bitlicense, which amounts to a framework for virtual currency businesses to operate in the State of New York. Denmark and Sweden announced that they would not ban or control bitcoin. China's crackdown on bitcoin trading and shutting down bitcoin exchanges caused a significant fall of the bitcoin price. In Vietnam cryptocurrency is considered an illegal non-cash payment method. As to France's position on the matter, the Senate report ranks the country halfway between the strictest jurisdictions, such as China, Japan and Russia, and the most lenient jurisdictions, such as the United States, Canada and Israel.

Russia has made the first step in setting up a legal framework to handling cryptocurrency. The Head of the Non-departmental working group on cryptocurrency turnover risk assessment of the State Duma of the Russian Federation Elina Sidorenko announced at the Blockchain Meetup held in Kazan on June 30, 2017 that the bill on legalization of cryptocurrencies in Russia is under way and to be introduced in the State Duma in October 2017. And though, as it was mentioned above, the majority of countries have not worked out a legal framework on cryptocurrency use, they have warned their citizens about the risks of investing in this type of electronic money. But it is not enough. It is necessary to create a legal framework that will stipulate the viable mechanism to protect the rights of business entities. This framework should be based on norms, containing basic definitions used in cryptocurrency circulation.

3. CONCLUSIONS

The research made it possible to draw the following conclusions on the legal regulation of cryptocurrency in Russia:

1. The unified state currency policy, stable domestic currency market and strong rouble are secured by law. Meanwhile, there exists an alternative system of tender. This situation is a serious threat to the financial stability in Russia. This problem can be solved by working out a legal framework that will reflect the attitude of the state toward the legitimacy of virtual electronic money and virtual payment scheme. The official position of the state must be backed up by the law.

2. There is no doubt that current currency legislation requires clarification and adjustment to blockchain technology. However, the solution of the problems needs a balanced approach: the law-making process must be based on the achievements of scientists and specialists.

3. The regulation of an alternative monetary system must be based on an elaborate nomenclature system. It can be done on a step-by-step basis. For instance, tax authorities can promptly work out an intradepartmental conceptual framework to recognize gains from cryptocurrency transactions as a taxable base. The definitions themselves must meet scientific

requirements and reflect the essence and peculiarities of defined phenomena.

4. The borrowing of international experience must be thought over. Numerous researches on the international practice of solving the problems touched upon in the present research indicate the ambiguity of state approaches to solving this problem, lack of a common approach to virtual monetary units and alternative monetary system. Russia must work out its own approach and do it as soon as possible because the delay of conflict resolution undermines the development of the society.

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