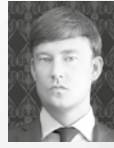


# The Legal Ambiguity of Crypto Payments Within the Gaming Industry: A Plea for a Crypto Directive

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Compared to conventional money, crypto assets have only been around for just a little while. Nevertheless, they have rapidly established themselves as a reliable method of payment within the gaming community and beyond. From a regulatory perspective, however, the journey has barely started. In this chapter, we shall discuss the global trends in the development of regulatory frameworks pertaining to crypto assets. Will authorities ever agree on a global legal definition of crypto assets? Why would it be important to find a consensus? Will crypto payments become the new standard for gaming? Do current regulations suffice? Is it essential for these purposes to introduce a new regulatory framework, specifically tailored to accommodate *crypto compliance*?

## The Gaming Industry Requires a Global Legal Definition of Crypto

The global community has not yet been able to reach a consensus on a legal definition for crypto. Some treat it as money, however crypto is so much more, as it could in itself guarantee the authenticity of all the transaction data, bets, deposits and withdrawals, which are then recorded on a public blockchain, ensuring transparency and security of all payouts to players, affiliates and other participants of the gambling ecosystem, at the same time guaranteeing the security of personal data of casino end-users.

The use of crypto brings exciting, much-needed enhancements to the gaming industry. In a regular casino, one may be able to track players' deposits and withdrawals in a rudimentary manner. However, monitoring what happens during a game itself has always remained a challenge. The exclusive use of crypto solutions would allow a decentralised setup of the casino, which would guarantee that involved records cannot be altered retroactively. This allows the participants to verify and audit transactions independently and relatively inexpensively. This may also prove extremely useful in combatting money laundering.

However, in order to make full use of its potential, the global community must come to a unilateral agreement on a definition of crypto. Is it treated as a currency or as an asset?

In the Netherlands, for example, Bitcoin, a well-known crypto asset, often referred to as a *cryptocurrency*, is from a legal viewpoint not necessarily qualified as a currency, but rather as a medium of exchange, with its own intrinsic value. Some even call it *Digital Gold*. Bitcoins are governed by a design decision by the developers of the core technology to limit its production to a fixed amount, namely 21 million tokens. An appeals court in the Netherlands ruled that Bitcoin is indeed not a digital currency:

*"Bitcoin is the peer-to-peer network that maintains a decentralized ledger 'the blockchain'. A 'Bitcoin' is the digital currency that is sent via the*

*Bitcoin network. The addresses to which bitcoins are sent consist of a unique series of numbers and letters. An overview of all generated addresses and transactions is kept in the blockchain. The Bitcoin protocol is designed in such a way that miners (people who make computer power available to check the validity of transactions) can be rewarded with a number of bitcoins for their work on the validity of those transactions."*<sup>1</sup>

Essential for this ruling is that the court deems it important that Bitcoin cannot be made available without the allocation of resources (man hours, electricity).

In its ruling dated July 24<sup>th</sup>, 2020, the U.S. District Court reached the opposite conclusion. This court ruled that the function that Bitcoin has in ordinary society should be compared to the function of money. The U.S. court, in short, looked up the definition of money in several dictionaries and compared if the functionality of money was comparable to the functionality of Bitcoin:

*"Any generally accepted medium of exchange which enables a society to trade goods without the need for barter; any objects or tokens regarded as a store of value and used as a medium of exchange." [...] "Money is also often regarded as a store of value." [...] "Bitcoin is just that — a medium of exchange, method of payment, and store of value." [...] "Bitcoin can be used to pay for goods or services."*

In other words: Bitcoin equals money in the view of this court as it can be used to *"pay for things"*.<sup>2</sup>

The latter does not sound very convincing to us, as it does not reconcile the essential difference between Bitcoin and money, namely the economic efforts locked up in Bitcoin, necessary to mine it, let alone the essential economic characteristic of scarcity. Bitcoin miners receive Bitcoins as a reward for completing "blocks" of verified transactions which are added to the blockchain. The mining of cash, however, does not exist. That is, if one does not include the act of counterfeiting, which would not meet the definition of mining anyway, as the act is aimed at producing a fake.

The highly volatile nature of traditional crypto assets that are not state-backed (which would potentially make it possible to label the asset as a currency) makes it very hard for those assets to become more widely adopted.<sup>3</sup> Central banks therefore usually refrain from using the term *cryptocurrencies* to refer to these crypto assets altogether.<sup>4</sup> We also rather speak of crypto assets, as a state-backed currency shall always qualify as an asset, but an asset does not always qualify as currency.

Could the end result of these tests differentiate between various types of crypto assets? Not really. The Venezuelan (state-backed) Petro,<sup>5</sup> for example, has (allegedly) been 100% pre-mined by its government, meaning that new tokens could not be created after its launch, which would guarantee the presence of the economic principle of scarcity, hence an intrinsic value. Crypto assets, in principle, always have intrinsic value.

## A Globally Agreed Upon Definition of Crypto Assets is Also Essential for Gaming Compliance Purposes

Why is it at all important how crypto assets are qualified? There are several reasons, of which by far the most important would be that without a global unified regulatory framework it shall, for lack of consistency, be impossible to come to proper enforcement, cross-border and otherwise.

An important reason to aim for one global unified understanding of crypto would be the need for consistency on how to treat crypto assets within the conventional understanding of finance, taxation and privacy regulations. After all, institutions maintaining the stability of the international markets are built and are relying on rules and regulations that have been designed to regulate conventional payment methods. If payment via crypto assets becomes mainstream, these rules and regulations may no longer match, as the differences between conventional currencies and crypto assets are simply too substantial. Nevertheless, legislators have been seeking ways to fit in crypto payment methods in existing legislation. We, however, feel that these efforts, in time, shall be certain to fail.

In its judgment dated October 22<sup>nd</sup>, 2015, the EU Court determined that transactions involving non-traditional currencies, defined by the EU Court as: *“currencies other than those that are legal tender in one or more countries, in so far as those currencies have been accepted by the parties to a transaction as an alternative to legal tender and have no purpose other than to be a means of payment, are financial transactions.”*<sup>6</sup>

The compensation received is the actual equivalent for the service provided. As a result, the EU Court has ruled that Bitcoin should be treated equally as any conventional currency. Hence, Bitcoin transactions have been exempted from Value Added Tax (“VAT”), as it falls within the exemption of Article 135 paragraph 1 under e of the VAT Directive (2006/112/EU). Although not deemed by the EU Court equal to money, it is treated as such, thus creating a special status for this form of payment. As mining Bitcoins would not be the same as trading Bitcoins, the next legal question is already on the table: whether or not miners should be allowed to deduct VAT paid on resources necessary to mine.<sup>7</sup>

Again – in essence, this judgment has been a prequel to the ruling of the U.S. District Court that we touched on – this criterion does not seem viable, as it just compares more advanced forms of payment to conventional, less advanced payments methods, such as payments in cash. The test wrongfully assumes that classic financial cash transactions would not be subject to evolution. Good old cash does not hold any intrinsic options. It needs banks and other institutions in order to be properly regulated. It cannot hold any information on its current, previous or future bearer. Hence, questions need to be answered whenever a transaction seems to be unusual and even then, the regulatory framework is not ideal and has many flaws.

Consistency is also needed for gaming tax purposes. For example, a winner of a non-cash prize, a car for example, is still required to pay gaming tax, as a universal principle, to be calculated on the economic value of this prize. Would the casino agree to pay the amount of incurred gaming tax on behalf of the player? Also, this would be regarded as a natural prize on its own, again incurring gaming tax over the gaming tax, paid on behalf of the player. This often happens, as most winners usually do not have the cash available to pay taxes over high-value natural prizes, such as cars or houses, forcing them to actually refuse the prize if the casino does not take care of the tax liability.

Such an effect would not transpire if a particular prize is considered to be a cash prize. It is not complicated to

(universally) qualify a car as a non-cash prize. With crypto assets, however, it would not be that simple. Firstly, it needs to be determined whether or not a crypto prize should be considered as a cash prize within the jurisdiction of the player, which is not necessarily equal to the jurisdiction of the casino. Who would be responsible for the payment of gaming tax, the player or the casino?

Secondly, if treated as a natural prize, how should the crypto prize be appraised for taxation purposes? What would be the economic value? The fluctuations in the value of Bitcoin are infamous. Marking an exact point in time for appraisal purposes will matter.

## Control

The rise of crypto will diminish the control of regulatory authorities. It is an inescapable consequence that parties will largely be responsible for transactions themselves. The more ambiguity in how crypto values are handled between parties, the more complicated it shall be to combat money laundering and the financing of terrorism. For example, the Venezuelan government (allegedly) designed the Petro to circumvent U.S. sanctions specifically tied to the control of the flow of money in and out of sanctioned countries.<sup>8</sup> At the start of 2020, over 5,100 crypto assets existed with a total market capitalisation exceeding \$250 billion.<sup>9</sup> The ongoing COVID-19 pandemic has furthermore accelerated the development of digital assets as a currency by central banks in an attempt to motivate the world population to turn to cashless payments. These developments are helping to chip away the influence of institutions around the world, an inviting prospect for countries that seek immunity from the world powers that be. Having independence sounds appealing; however, that perspective might change if that same strive for independence is pursued by rogue states seeking new means to finance terrorism. Such diversity would make a global attempt to effectively combat money laundering and the financing of terrorism impossible.

## Out With the Old?

What if mainstream methods of payment, as a standard, would in itself be able to generate additional information that could be used for enhanced functionalities, related, however not essential, to the payment itself? Would that not be preferable to the current system?

Lithuania’s Central Bank, for example, has been developing the “LBCOIN” as part of its trial of blockchain technology and digital currencies. Meant as an experiment, rather than an actual method of payment, each token features a portrait of one of the 20 signatories of Lithuania’s declaration of independence signed in 1918, which have been divided into six categories: priests; presidents; diplomats; industrialists; academics; and municipal aides. Collectors are able to trade tokens and then exchange a specific set for a physical silver coin worth €19.18. The experiment is meant to engage more people, especially the youth, in coin-collecting while gaining valuable experience and knowledge in the field of digital currencies.

The LBCOIN is an example of a crypto asset with an enhancement for cultural purposes attached to it.<sup>10</sup> It is just one example. The possibilities are endless. What if payment methods could even be tailored to specific business branches?

## Enhancing Markets by Payment Methods Tailored to Specific Business Branches

KODAKCoin is designed as a photographer-oriented blockchain cryptocurrency, that is planned for payments for licensing

photographs. It offers a so-called post-licensing solution for intellectual property. It directly ties users of copyright-protected images to its legitimate owners, hence it is called post-licensing. It uses web crawlers to identify intellectual property licensed to the *KodakOne* platform, an ingenious method of enhancing copyright protection and at the same time stimulating trade in copyright-protected imaging.

### Crypto Assets Can Also Resemble Regulated Financial Instruments

How should crypto assets which share characteristics with conventional financial instruments as defined in the Markets in Financial Instruments Directive (2004/39/EC, currently: MiFID II) be dealt with? A stablecoin is designed to minimise the volatility of its price, relative to some “stable” asset or basket of assets. It can be tied to money or exchange-traded commodities (such as precious metals or industrial metals). As its value is derived from the performance of an underlying entity, it essentially qualifies as a derivative, a (regulated) financial instrument as defined in MiFID II.

### Towards a Sustainable Regulatory Future in Gaming: The Crypto Directive

The point that could be made here is that the courts cannot go on comparing enhanced future assets to conventional assets that they are familiar with. The world has changed. Crypto assets require a new take, a fresh regulatory perspective.

The world might have to get used to the fact that conventional money trails will not be able to effectively safeguard against money laundering. As services become increasingly complex, methods of payment for such services should enhance as well. Crypto assets would be suitable; however, their nature does not allow for centralised oversight by, for example, banks as the information on transactions will be processed, not on a centralised level but within the (decentralised) ledgers. Also, it cannot be regulated by rules and regulations that have been tailored to regulate money transactions, as crypto assets have their own, intrinsic value. They represent means of exchange.

With a Crypto Directive, EU Member States would be able to respond to the regulatory winds of change. The community would acknowledge that paying with means of exchange rather than with money will, in time, be much easier and safer, provided that proper quality standards for crypto currencies are introduced. The LBCOIN, as mentioned, has a cultural upside but nothing prevents, at this time, the introduction of crypto assets that are specifically tailored to facilitate the financing of terrorism.

When properly regulated, as said, the possibilities would be endless. Crypto assets could even be tailored to enterprise levels. If international corporations, for example, are regulated

to use a specific kind of crypto asset, one would be able to track, directly or indirectly, any payment, as a DNA trail so to speak. This would allow the global community to, with each transaction, *de facto* enhance the enforcement of sanctions in the battle against the financing of terrorism and money laundering. Pretty much equal to forensic analysis using DNA, it would also become possible to resolve financial “cold” cases, years after transactions have transpired, using data that has become available at a later time, to “connect the dots”.

A unilateral understanding of crypto would also pave the way for integration of so-called “smart contracts”. Embedded in blockchain solutions, it would force parties to comply with applicable terms and conditions, as established between the parties. It would largely mean the end of the time-consuming player disputes as we know them. For this however to work, there needs to be a universal consensus on the parameters.

Last but not least, regulations are required in order to start mitigating carbon footprints. After all, the carbon footprint connected to mining activities (electricity, cooling) of Bitcoin alone is already matching the carbon emission of a small country.<sup>11</sup> Another reason why regulating crypto assets will never become effective if treated by the powers that be as just another exotic currency.

### Endnotes

1. Appeals Court Arnhem-Leeuwarden, the Netherlands, May 31<sup>st</sup>, 2016, ECLI:NL:GHARL:2016:4219, section 2.6.
2. U.S. District Court for the District of Columbia, case number 1:19-cr-00395-BAH, page 15.
3. H. DE VAUPLANE, “Cryptocurrencies and Central Banks” in J. MADIR (ed.), *Fintech – Law and Regulation*, Cheltenham, Edward Elgar Publishing, 2019, (102) 113.
4. Cf. OMFIF and IBM, “Retail CBDCs. The next payments frontier”, 2019, 9, <https://www.omfif.org/wp-content/uploads/2019/11/Retail-CBDCs-The-next-payments-frontier.pdf>.
5. <https://www.petro.gob.ve/>.
6. Judgment of the EU Court in the matter of *Hedqvist v Swedish tax and customs administration*, Case C-264/14, Considerations 47-49.
7. Lower Court of the Hague, Netherlands, July 15<sup>th</sup>, 2020, nr. 18, 8226, ECLI:NL:RBDHA:2020:7543.
8. <https://time.com/5206835/exclusive-russia-petro-venezuela-cryptocurrency>.
9. Statement made on the basis of data derived from <https://coinmarketcap.com> on 4 March 2020.
10. <https://www.euronews.com/2020/07/09/explainer-what-is-lbcoin-the-new-lithuanian-state-backed-cryptocurrency>.
11. <https://edition.cnn.com/2019/06/14/tech/bitcoin-carbon-footprint-trnd>.



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