WARDYŃSKI & PARTNERS

Virtual currency report summary

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The recent dynamic growth of virtual currencies presents the increasingly realistic chance of creation of an entirely new model of money and payment. Innovations allowing payments to be made at lightning speed, across state borders and outside of official payment systems, are appearing before our very eyes. Such payments are made without the involvement of banks or intermediaries, and often anonymously. This is a revolution not only for traditional payment systems, but also for the law. Virtual currencies reveal numerous legal issues that could not even have been imagined before.

The magnitude of the challenges posed by virtual currencies may be easily grasped by asking a few fundamental questions. If there is an error when carrying out a Bitcoin transaction, does the party have any kind of claim? Whom would the claim be against? Is theft of virtual currencies a crime at all? If so, where is it committed? Can Bitcoins be inherited? Can Bitcoin be pledged as collateral? If so, what would be the governing law? These are just a few examples of the questions that must be faced when looking closer at the nature of virtual currencies.

In this context, is Polish law prepared for the approaching revolution? Sooner or later Polish lawmakers will have to take a position on this new dimension of money. They face a difficult challenge. They should assure that virtual currencies function safely, while at the same time avoiding excessive regulatory interference which could hamper the development of a field that is already proving to offer great potential.

This publication is an abbreviated version of a report on the legal and tax aspects of virtual currencies drafted by Wardyński & Partners in July 2014.

The report was prepared on the basis of Polish law in force as of 30 June 2014. We must stress that the views expressed in this publication are based on the individual reasoning of the authors and do not constitute a legal opinion or other formal statement by Wardyński & Partners.

Summary

1. As in most other jurisdictions, trading in virtual currencies is practically unregulated in Poland at this time. On one hand, this situation opens the way to dynamic and unfettered development of new payment solutions. But this also comes at a price of greatly reduced protection for users of virtual currencies as compared to traditional currencies. At this time public institutions do not have instruments for effective oversight of entities operating in the area of virtual currencies. Changing this state of affairs would require quite fundamental modification of the existing regulations.
2. Polish regulations do not directly address virtual currencies. This makes it hard to determine which provisions of Polish law could potentially be applied to new forms of money. Our analysis leads to the conclusion that in Polish normative regulations, most of the definitions of concepts broadly related to money do not cover virtual currencies. It cannot be ruled out that some virtual currencies may qualify as electronic money for purposes of the Payment Services Act, but this does not apply to the most popular and innovative currencies at this time, such as Bitcoin. It could easily be assumed that virtual currencies are a property right for purposes of the Civil Code. Although this definition is vitally important for the civil law, it is hardly used at all in laws imposing administrative regulation of the financial services market. The definitions used in administrative regulations governing various financial services refer rather to traditional forms of money, which essentially excludes the possibility of applying these regulations to virtual currencies. Because the Polish regulations are not unequivocal, a number of doubts are raised whether specific regulations apply to virtual currencies. This is particularly apparent under provisions of criminal law, tax law, and the regulation of payment services. In the longer term, this situation is not beneficial to users of virtual currencies. For this reason, legislative intervention to clarify the legal situation of entities participating in trading of virtual currencies would be desirable. At the same time, it must be emphasised that because of the strong interdependence among various regulations, the introduction into Polish law of a normative definition of virtual currencies must be a coordinated initiative.
3. Introduction of a normative definition of virtual currencies would need to reflect the variety in the models for such currencies. Lawmakers should first conduct a review of the existing models of virtual currencies and determine which models should be covered by the normative definition. Given

the dynamic development of virtual currencies, any normative definition should also enable the definition to be extended to cover models arising in the future.

4. In the context of possible creation of a normative definition of virtual currencies, it is essential to take into account the international aspect. Payment solutions based on virtual currencies are global in nature. Therefore, when creating a definition of virtual currencies for the purposes of Polish law, it would be worthwhile to reflect the definitions used in other jurisdictions. To create effective legal tools in the area of virtual currencies, it appears essential to unify such definitions. This would be vitally important, for example, in the context of criminal law and tax law. It should also be noted that because payment services are currently the subject of European law, it should be assumed that the normative conception of virtual currencies will be the subject of coordinated initiatives at the European Union level.

5. The legal protection of users of virtual currencies under the current state of the law is minimal, and essentially boils down to application of general regulations of civil law. This is because the great majority of services related to virtual currencies are not regulated. Users of virtual currencies thus cannot take advantage of the protections afforded by such laws as the Payment Services Act or the Act on Trading in Financial Instruments. The legal situation of users of virtual currencies thus stands in contrast with the situation of users of more traditional media of payment.

6. Particularly disturbing is the weakness of criminal law protection of users of virtual currencies, compared to users of traditional forms of money. The possibility of applying selected provisions of the Penal Code to "theft" of Bitcoin demonstrates that in the area of criminal law, legislative intervention to protect the growing number of users of virtual currencies is urgently needed. The concepts used by the Penal Code at this time do not provide an unequivocal answer to the question of whether virtual currencies are a medium of payment for purposes of the Penal Code. Consequently, it is extremely difficult to determine whether virtual currencies can be the subject of a great many offences (e.g. theft or alteration of a medium of payment). There is an axiological inequality in the protection of users of traditional currency, e.g. in the case of theft of a wallet containing cash, and the protection of users of virtual currencies, which often perform an economic function similar to that of money and are also a medium carrying value. The economic meaning of "theft" of virtual currencies is identical to the theft of legal tender or a payment card, but theft of virtual currencies as such is not punishable. There appears to be a need for legislative initiative to eliminate this state of affairs. It would be desirable in this respect for the criminal law to be applied effectively in various situations while maintaining the appropriate precision in defining the nature and grounds of criminal responsibility. A good example here would be Penal Code Art. 267 §1 (obtaining unauthorised access to information), which appears to be capable of serving its purpose even in atypical factual situations.

7. Recognition of virtual currencies as legal tender in Poland would require amendments to current law. At this time both the Constitution (Art. 227(1)) and the Act on the National Bank of Poland (Art. 4 and 32) provide that the central bank has the exclusive right to issue legal tender in Poland. Meanwhile, "legal tender" is understood narrowly and is limited to banknotes and coins. The decentralised process of issuing many virtual currencies and their dematerialised character currently exclude treating them as legal tender in Poland. Therefore they do not have the legal effect of discharging a monetary obligation. In this respect it should be pointed out that even non-cash forms of currency (e.g. bank money) which are much more widespread than virtual currencies are formally not regarded as legal tender. This is a particularly sensitive situation because more and more laws (such as the Business Freedom Act) require various entities to make non-cash payments. Leaving aside whether introduction of legal solutions enabling virtual currencies created in a decentralised manner to obtain the status of legal tender should be considered, consideration should nonetheless be given to recognising certain forms of non-cash money as legal tender.

8. In the case of virtual currencies which are created in a decentralised manner and are not issued as an equivalent for traditional money, the process of creation of such currencies does not require any licence under current law. In the case of virtual currencies which qualify as electronic money for purposes of the Payment Services Act, the process of issuing such virtual currencies may require a licence.

9. Under the current state of the law, application of the Payment Services Act to most types of virtual currencies is highly doubtful. It cannot be ruled out that some virtual currencies will meet the criteria for classification as electronic money for purposes of the Payment Services Act. With respect to such currencies, the act would apply. But in the case of decentralised currencies (e.g. Bitcoin), such classification appears impossible. Due to the numerous exclusions set forth in the Payment Services Act, the act will not apply to such currencies. This means that trading in such currencies is not regulated. Nor are public administrative bodies vested with authority derived from the act to supervise entities which organise or participate in trading of such currencies. On the other hand, users of virtual currencies are deprived of the protections provided by the Payment Services Act, including such aspects as requirements to provide information to users, or the levels of interchange fees. In effect, there is a situation in which trading in virtual currencies, although beginning to perform a function similar to trading in traditional media of payment, is subject to much lighter requirements than trading in traditional currencies. A change in this state of affairs would require amendment of the Payment Services Act, primarily with respect to the definitions used in the act and the exclusions provided for in the act.

10. As long as a virtual currency is not regarded as a financial instrument (and there are little grounds for doing do), organised trading in that currency will not be subject to regulation under the Act on Trading in Financial Instruments. Similarly, intermediation in trading in virtual currencies will not constitute brokerage

activity regulated by the act. Nonetheless, it is highly probable that derivative instruments based on virtual currencies could be regarded as a financial instrument for purposes of the Act on Trading in Financial Instruments.

11. The provisions of the Anti-Money Laundering Act generally also cover transactions involving virtual currencies. In this sense, it may be said that this is one of the few laws that are to some extent prepared for the growing role of virtual currencies. In practice, however, some of the provisions of this act would need to be modified to suit trading in virtual currencies. This applies more specifically to the rules for calculating the value of transactions for the purpose of performing registration obligations (e.g. Art. 8(1)), which clearly do not reflect the nature of virtual currencies. Whether it is possible at all to fulfil the statutory duties under this act with respect to virtual currencies, given the technical aspects of how such currencies operate, is another issue entirely. It may be assumed, for example, that in the case of many virtual currencies it may prove extremely difficult to comply with "know your customer" requirements or the requirement to block transactions in certain situations.

12. Without amendment of the Foreign Exchange Law, activity involving exchange of virtual currencies into Polish currency will not be regulated as bureau-de-change operations. Moreover, due to restrictions in the definition of "foreign currencies" in the Foreign Exchange Law, as long as the exchange of virtual currencies into foreign currencies is conducted in a cash-free manner (i.e. without using banknotes or coins), it will not be regulated as bureau-de-change operations. Under the current state of the law, only activity involving the exchange of virtual currencies into foreign currencies in the form of banknotes or coins would be regulated as bureau-de-change operations. It should therefore be assumed that under current law, the great majority of entities conducting exchange of virtual currencies on the Internet will not be subject to oversight by the National Bank of Poland.

13. Pursuant to the amendments to the Anti-Money Laundering Act which went into force in 2013, it should be assumed that activity involving exchange of virtual currencies into traditional currencies (whether in cash or non-cash form) will be subject to the act. Doubts arise however in the context of activity involving exchange of virtual currencies into other virtual currencies (assuming that such activity is not an element of other activity which is subject to the Anti-Money Laundering Act under other provisions of the act).

14. Under current law, users of virtual currencies are exposed to a particular tax risk. The lack of regulations specifically addressing e-currencies means that the tax consequences of operations involving virtual currencies are derived from general regulations, which are ill-suited to the nature of such operations. Such operations must therefore be undertaken cautiously. Until clear rules for taxation of e-currencies are developed, the tax interests of users of such currencies may be protected by obtaining individual interpretations of tax law.

    The tax risk is primarily tied to the lack of a uniform legal classification of e-currencies. It is therefore vital to introduce

a legal definition of virtual currency. Lawmakers should also take into account the nature of virtual currencies, particularly the anonymity of their users, which often makes proper documentation and settlement of operations using virtual currencies difficult or impossible. A solution could be to implement special provisions permitting limitation of the scope of information disclosed in financial documents, or permitting documentation of such operations using specific documents, e.g. appropriately structured confirmation of performance of operations on e-currency exchanges. In the context of the tax burden as such, a VAT exemption for trading in virtual currencies should at least be considered. This would require recognition of operations using virtual currencies as financial services, which would appear appropriate to the nature of such operations. It would also reflect the positions taken by tax authorities in other jurisdictions, which in light of the cross-border flow of virtual currencies would allow settlements to be conducted consistently.

The globalisation of trading in e-currencies requires continual tracking of legislative changes in other countries as well as at the EU level. VAT harmonisation generally requires that transactions of the same type be treated uniformly. Legislative measures undertaken in Poland should therefore be coordinated with initiatives on the international forum. This requires adequate preparations on the part of Polish fiscal authorities to assure that the decisions that are taken are consistent with the interests of the Polish Treasury, while at the same time not blocking the apparently inevitable growth of virtual currencies.

New Technologies Practice

For us, new technologies are all about new legal challenges. In many instances, we must tackle doubts surrounding the legal treatment of innovative products and services or an absence of relevant regulations. To assure clients legal security in such circumstances, lawyers must bring to the table experience, creativity, and an understanding of the business environment.

Therefore we have created an interdisciplinary New Technologies Practice within the law firm, bringing together highly skilled practitioners from selected fields of law. We are supported by technology experts cooperating with the firm and offering a wide range of technical knowledge.

We strive to meet our clients' needs as they arise by creating highly specialised legal services addressed to specific segments of the new technologies market. We provide comprehensive regulatory, tax and transactional advice.

Based on our existing experience, we have identified the following areas of our practice: biomedical and modern foods, creative industries, crowdfunding, cybersecurity, e-commerce, financing of new technologies, gaming, information technology, new payment solutions, new technologies in searching for energy, public-private partnership projects (PPP), protection of privacy, research and development (R&D), telecommunications.

Anna Pompe
Adwokat, partner

E-mail: anna.pompe@wardynski.com.pl
Tel.: (+48) 22 437 82 00, 22 537 82 00

Krzysztof Wojdyło
Adwokat

E-mail: krzysztof.wojdylo@wardynski.com.pl
Tel.: (+48) 22 437 82 00, 22 537 82 00

Joanna Prokurat
Tax adviser

E-mail: joanna.prokurat@wardynski.com.pl
Tel.: (+48) 22 437 82 00, 22 537 82 00

Piotr Rutkowski
Technology adviser

E-mail: piotr.rutkowski@wardynski.com.pl
Tel.: (+48) 22 437 82 00, 22 537 82 00

About Wardyński & Partners

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The firm's practice is focused on such areas as arbitration, banking, bankruptcy, capital markets, competition law, corporate law, dispute resolution, employment law, energy law, environmental law, EU law, infrastructure projects and public-private partnership, intellectual property, maritime law, mergers and acquisitions, pharmaceutical law, project finance, public procurement, real estate, tax and tax disputes, and technology, media and telecommunications.

The firm publishes the Litigation Portal, presenting news and analysis concerning judicial, arbitration and administrative proceedings, and the Transactions Portal, which addresses legal aspects of M&A transactions on the Polish market. Both portals are available in Polish and English versions.

The firm is also the publisher of Wardyński+, the first Polish-language app on legal topics for iPad and Android. The app is available free of charge at the App Store and Google Play.

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Wardyński+

Wardyński & Partners
Al. Ujazdowskie 10
00-478 Warsaw
Poland

Tel.: (+48) 22 437 82 00, 22 537 82 00
Fax: (+48) 22 437 82 01, 22 537 82 01

E-mail: warsaw@wardynski.com.pl