This Economic Note presents an analysis of the situation in Canada and in other countries that have adopted regulatory frameworks for Bitcoin.1

Three conditions would need to be met for the expansion of the use of Bitcoin as a currency, which remains very limited at the moment (see Figure 1). First, users would need to receive concrete benefits from the use of this currency rather than some other one, a condition that is related to the nature of Bitcoin and its mechanics.2 Retailers, consumers and investors would also need to know that there exist clear rules indicating how Bitcoin is to be treated in terms of taxation and regulation. These rules can bolster the confidence of a growing number of users toward the digital currency and eliminate uncertainty for investors, thereby encouraging investment in Bitcoin companies. Finally, the proposed rules must not hamper the use of Bitcoin as a means of exchange, either with burdensome taxes or with excessive administrative rules for users.

These last two conditions depend on political decisions. The role of governments regarding the means of exchange is generally limited to the recognition of currencies as legal tender, but decisions related to its tax treatment and financial regulatory framework can either help or hinder Bitcoin’s development.

The regulatory situation in Canada

Canada is the second most popular destination for venture capital invested in Bitcoin companies, behind the United States and ahead of China (see Table 1). It therefore benefits from the jobs and the economic spillover related to this new industry.

Revenue Canada became the first Canadian governmental authority to issue an official statement regarding Bitcoin when it declared that it considered bitcoins to be simple goods exchanged under a barter system.3 This entails an obligation for retailers to declare the revenues from such transactions when they accept Bitcoin as the method of payment. If bitcoins are bought or sold for purposes of investment or speculation, any profits or losses must be considered capital gains or losses and will be taxed as such.

The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC),
whose mandate is to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities, has also addressed the matter. The agency indicated to several Canadian Bitcoin companies, such as exchanges, that they were not considered money services businesses (MSBs) and that they were therefore exempt from money laundering laws.4

In the February 2014 federal budget, however, the government announced its intention to introduce legislative amendments to strengthen Canada’s anti-money laundering and anti-terrorist financing regime in order to better address emerging risks, including those associated with virtual currencies.5 Before the Standing Senate Committee on Banking, Trade and Commerce, a representative of the Finance Department stated that these legislative modifications could include Bitcoin exchanges in the definition of money services businesses, but not individuals or other businesses.6 The representative justified this approach by pointing out that it will allow for “financial innovation.”

If these changes materialize, this clarification of rules would be a positive development for Bitcoin in Canada. Among other things, it could facilitate interaction between banks and Bitcoin companies, as Canadian banks remain cautious in anticipation of more specific regulation with regard to Bitcoin.7 Worried about running afoul of existing money laundering laws in particular, several of them avoid offering banking services to Bitcoin companies. Without basic services like a simple business bank account, many Bitcoin companies will choose to set up shop elsewhere, leading to economic losses for Canada.

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**The United States**

In general, the United States has up until now seemed relatively open to digital currencies. A Senate committee held hearings on the future of Bitcoin in November 2013, highlighting its potential for growth and innovation. A few months later, the State of New York initiated procedures for the regulation of Bitcoin and other digital currencies. New York State’s Department of Financial Services held hearings in order to explore the possibility of adopting rules that would allow digital currency companies to grow and to continue to innovate, all while protecting consumers and preventing criminal activities like money laundering. The head of the department recently indicated that certain companies, such as exchanges, will be regulated using “BitLicenses,” according to terms that will be specified in the near future.8

As in Canada, the American tax agency (the IRS) has given Bitcoin a tax status, indicating that it considered it taxable “property.”9 Any profits resulting from holding or exchanging bitcoins could be subject to the capital gains tax. This measure is causing some concern among certain bitcoin users who dread the administrative burden that this would represent. For example, a consumer could be required to calculate the capital gains for each bitcoin used before making a purchase.

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Note: Bitcoin’s total daily transaction volumes averaged $68 million in February 2014. Transactions carried out through Western Union and PayPal averaged $225 million and $492 million respectively at the end of 2013. As for transactions carried out with Visa and MasterCard credit cards, they averaged $19 billion and $11 billion a day.
This tax treatment, by undermining a fundamental use of Bitcoin, namely that of a currency facilitating all sorts of transactions, could discourage the use and adoption of this digital currency.\textsuperscript{10} Still, the IRS’s decision has the merit of clarifying the rules, insofar as buyers and sellers of bitcoins now know the tax implications of their transactions, and know that they can carry out those transactions legally.

For the same reason, the eventual BitLicenses that the State of New York is preparing to launch can be seen as a positive development for Bitcoin, as they will strengthen consumers’ confidence in the companies that hold them. It remains to be seen if these rules will be excessive or not. But so far, American regulatory bodies seem to attach great importance to the potential gains from Bitcoin in terms of innovation and economic spillover.\textsuperscript{11}

\textbf{Germany}

If Canada has so far been considered a welcoming place for Bitcoin, the same can be said of Germany, which was one of the first countries to regulate it. In December 2013, the German Finance Department recognized bitcoins as a financial instrument similar to an international currency, which can be used to carry out private transactions or exchanged for other currencies, without being legal tender.\textsuperscript{12}

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Moreover, this country saw the emergence of the first partnership between a bank and a Bitcoin exchange. In July 2013, Bitcoin Deutschland GmbH, the company that manages the exchange platform Bitcoin.de, entered into a partnership with Fidor, a bank, in order to provide banking services to Bitcoin.de clients. These services are subject to the regulations in effect in the German financial market, including regulations dealing with money laundering.\textsuperscript{13}

Germany also stands out from other countries by the clarity of its rules. The various commercial activities that use bitcoins are regulated very specifically. The German regulatory authority (BaFin) determines if a licence is required or not for various types of companies. By reducing uncertainty regarding the regulatory implications of Bitcoin, the authorities make it easier for companies to make decisions and encourage the creation of business partnerships like the one between Fidor and Bitcoin.de.\textsuperscript{14}

These clear rules, as well as a tax treatment that allows Bitcoin to be used as a currency, explain why the digital currency is popular in Germany and why this country was one of the first Bitcoin hubs.

\textbf{Conclusion}

In order for Bitcoin to develop its potential and be adopted by a growing number of users, clear rules are required, along with some kind of governmental acceptance. This acceptance does not necessarily imply official recognition as a “currency,” much less as legal tender, but rather that its fiscal status not prevent Bitcoin from being used in a manner similar to a currency. So far, Germany seems to have done the best job of meeting these two criteria. Recent developments in Canada also point to a regulatory environment that is favourable to Bitcoin.

In contrast, other countries are considered unamenable to Bitcoin. In China, the government and the Central Bank have forbidden banks from carrying out commercial operations using bitcoins, although individuals remain free to do so.\textsuperscript{15}

<table>
<thead>
<tr>
<th>Countries</th>
<th>Value (\textdollar{}M)</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>68.1</td>
<td>16</td>
</tr>
<tr>
<td>Canada</td>
<td>10.5</td>
<td>2</td>
</tr>
<tr>
<td>China</td>
<td>8.0</td>
<td>3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>5.0</td>
<td>2</td>
</tr>
<tr>
<td>Singapore</td>
<td>3.8</td>
<td>2</td>
</tr>
<tr>
<td>South Korea</td>
<td>0.8</td>
<td>2</td>
</tr>
<tr>
<td>Australia</td>
<td>0.7</td>
<td>2</td>
</tr>
<tr>
<td>Sweden</td>
<td>0.6</td>
<td>1</td>
</tr>
</tbody>
</table>

exclusive method of payment and that no other monetary unit can be introduced into the market. All prices must therefore be displayed in rubles for financial transactions. So while no regulations frame the use of Bitcoin, existing legislation makes its use potentially illegal, even for individuals.  

Several types of existing legal status could be generally suitable for Bitcoin. Including Bitcoin exchanges within the definition of money services businesses, as discussed in Canada, could be a promising avenue. The BitLicenses experiment planned by the State of New York also deserves to be evaluated in order to see if the advantages outweigh the disadvantages. In any case, a starting point would be to clarify the status of Bitcoin—and of Bitcoin companies—within the existing regulatory framework, so that consumers, companies and investors are well aware of the applicable rules.

In order for Bitcoin to develop its potential and be adopted by a growing number of users, clear rules are required, along with some kind of governmental acceptance.

While more precise rules are a precondition for the growing acceptance of Bitcoin, they can also have their drawbacks. Bitcoin is a technology that is constantly evolving, and that has multiple uses. The rules that regulate Bitcoin should ideally remain flexible and be adapted to this fluid character so as to give free rein to innovation.