Tikrit University Journal For Rights Year (8) Vol (8) NO (3) Part (1) (2024) 1-13
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ISSN: 2519 – 6138 (Print)
E-ISSN: 2663 – 8983(On Line)

TUJR
مجلة جامعة تكريت للحقوق
Tikrit University Journal for Rights

IRAQI Academic Scientific Journals
العراقية المجلات الأكاديمية العلمية

Tikrit University Journal for Rights
Journal Homepage : http://tujr.tu.edu.iq/index.php/t

كليـة القانـون
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Digital currencies are a means of money laundering and tax evasion

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Article info.

Article history:
- Received 13 November 2023
- Accepted 31 December 2023
Available online 1 March 2024

Keywords:

-digital currentcies
- encrypted virtual currencies
-money laundering
-tax evasion.

Abstract: Digital currencies (encrypted virtual currencies) are one of the modern technological phenomena that appeared nearly two decades ago and are widely used among multiple segments of society, among amateurs and professionals, ordinary individuals and merchants, private institutions and some entities, and the purpose of their use is usually to reduce fees, or avoid paying tax obligations for financial transactions conducted through them, or avoid criminal responsibility for money laundering or terrorist financing. Despite the many advantages that these digital currencies enjoy. In Iraq, they are described as illegal because they were not issued by an approved official body and were not regulated by specific legal rules. Digital currencies (encrypted virtual currencies) are used illegally for the purposes mentioned above. Given the risks resulting from illegal dealing in it, it requires a serious stance from the legislator to protect the economy, national security, and public money.

العملات الرقمية هي وسيلة لغسل الأموال والتهرب الضريبي

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معلومات البحث :

تواريخ البحث:

- الاستلام : ١٣/ تشرين الثاني/ ٢٠٢٣
- القبول : ٣١ / كانون الاول/ ٢٠٢٣
- النشر المباشر : ١/ اذار/٢٠٢٤

الكلمات المفتاحية :

- العملات الرقمية
- العملات الافتراضية المشفرة
- غسيل الأموال
- التهرب الضريبي.

الخلاصـــة: ملخص: تعتبر العملات الرقمية (العملات الافتراضية المشفرة) إحدى الظواهر التكنولوجية الحديثة التي ظهرت منذ ما يقرب من عقدين من الزمن وتستخدم على نطاق واسع بين شرائح متعددة من المجتمع، بين الهواة والمحترفين، والأفراد العاديين والتجار، والمؤسسات الخاصة وبعض الجهات، ويكون الغرض من استخدامها عادة هو تخفيض الرسوم، أو تجنب دفع الالتزامات الضريبية عن المعاملات المالية التي تتم من خلالها، أو تجنب المسؤولية الجنائية عن غسل الأموال أو تمويل الإرهاب. وعلى الرغم من المزايا العديدة التي تتمتع بها هذه العملات الرقمية. وفي العراق توصف بأنها غير قانونية لأنها لم تصدر عن جهة رسمية معتمدة ولم تنظمها قواعد قانونية محددة. يتم استخدام العملات الرقمية (العملات الافتراضية المشفرة) بشكل غير قانوني للأغراض المذكورة أعلاه. ونظراً للمخاطر الناجمة عن التعامل غير المشروع بها، فإن الأمر يتطلب موقفاً جدياً من المشرع لحماية الاقتصاد والأمن القومي والمال العام.

Introduction: The global monetary system has witnessed developments in recent years, the most important of which was the emergence of digital currencies (encrypted virtual currencies), of which Bitcoin is the most widespread. Despite the global concerns this currency has raised due to the extreme fluctuations in its value, in addition to the presence of many risks associated with it, it has begun gradually gaining the trust of some traders on the Internet due to its decentralization and flow in issuance and circulation, furthermore to the possibility of benefiting from the financial services associated with it easily and conveniently through the trading platforms spread over the Internet, which prompted some institutions around the world to accept it as a means of payment.

In Iraq, recently, there has been a great demand from Iraqis to join the world of digital finance. The size of the influx reflects a belief among a segment of Iraqis that their salvation from the setback of the Iraqi dinar against the US dollar, and to avoid heavy losses with the dinar's exchange rate continuing to rise against hard currencies will be by escaping to cryptocurrencies. Some groups, individuals or institutions are also searching for more financial places. It is safer and has a better future than paper money.

Hence the importance of knowing the nature of these currencies and their risks. One of the most important difficulties facing countries' attempts to regulate virtual currencies of various types lies in the lack of an approved unified concept for them, which negatively affects determining their legal nature. A lot of discussions and interpretations arose to narrow its definition and give it a specific legal description, which we will address in the first topic so that we will present the concept of digital virtual currencies and their characteristics.

On the other hand, the risks of virtual currencies made individuals lose confidence in trading them due to the unofficial issuance process and the fluctuation of their prices. With their spread, various risks appeared to the official authorities, represented in several aspects, such as the risks related to their use as a means of money laundering and tax evasion, which we will refer to in the second section because they are associated with them. It is necessary to explain the risks of virtual currencies, and then suggest some points that may contribute to addressing the aforementioned risks.

1.1 Study problem:

The problem of the research lies in the inability of countries, including Iraq, to control these currencies due to their decentralized system, and the loss of the ability to confront their risks. This is what calls us to search for solutions to reduce their risks and prevent their illegal use. Dealing in such currencies will lead to spreading chaos in the local money and exchange market, and many challenges and legal problems will arise that are involved in using these currencies in the absence of any central reference for them or supervisory authority over their issuance, circulation, or determination of their values. Accordingly, an appropriate method and legal framework must be found to limit dealing with virtual currencies, especially in Iraq, to reduce their risks.

1.2 Study importance:

The importance of the research stems from the necessity of finding the appropriate mechanism to deal with virtual currencies, which have become a reality that must be dealt with slowly and rationally. We stress the need not to ignore this reality or pressure to ban or criminalize those who deal with them because that will not lead to their disappearance or the end of the concerns they raise. Legal or economic problems. As we mentioned above, the rise in their values to record levels and the increase in the number of their users necessitate, without a doubt, the need to quickly establish a comprehensive legal framework for them that is capable of confronting their risks. Regulating encrypted virtual currencies is the best solution to address any concerns resulting from dealing with them.

1.3 Study Methodology

To complete this research honestly and accurately, it was necessary for us to research the topic of virtual currencies in detail, or to know the history of their inception and the reasons for trading in them, and to explain their nature, characteristics and advantages, and the international and local position on them and trading in them, and to know whether there are risks in dealing with them. What we previously mentioned made me follow the comparative analytical approach, to know its legal organization to develop proposals about some of the legal frameworks necessary to regulate it and ward off its dangers.

1.4 Study structure

We will divide our research, which we will present below, according to the following: In the first section, we will address the concept of virtual currencies and their risks to Iraq. In the second section, we will address the regulation of virtual currencies to ward off their risks in Iraq.

1. THE CONCEPT OF VIRTUAL CURRENCIES AND THEIR CHARACTERISTICS

In recent years, it has been noted that several Iraqis have turned to the world of digital money and cryptocurrencies. In their opinion, it saves them from the setback of the Iraqi dinar against the US dollar, and saves them from their losses, especially with the continued rise in the dinar's exchange rate against the dollar. The only recourse they had was to escape to virtual cryptocurrencies. Therefore, in this section, we will discuss the definition of digital virtual currencies, and then explain their characteristics.

2.1 Definition of digital virtual currencies

There is no agreement on a specific definition of digital currencies, mainly because of the diversity of the techniques involved in transferring balances digitally and their successive development. (Abu Salah, 2018, p 9) The viewpoints of international organizations and central banks may differ regarding the definition of digital currencies. Some of them restrict the definition and limit it to a specific form and activity, and some of them go towards expanding the concept and making it comprehensive for all forms of currencies that are traded and dealt with through the Internet, regardless of technical means. The modern ones are relied upon to provide these currencies. (Shaaban and others, 2020, p 7)

The beginning of attempts to define digital currencies dates back to 2012 by the European Central Bank as "a type of unregulated digital money, which is issued and usually controlled by developers and is used and accepted among members of a particular virtual community." (Mohammedi, 2019, p 618)

The US Treasury Department defined it in 2013 as "a medium of exchange that functions as a currency in some environments but does not have all the characteristics of real currency."(Abdul Latif & Noman, 2020, p 5) Some define it as "a virtual digital currency (that has no tangible physical entity or physical presence) produced by computer programs that are not subject to control or control by a central bank or any official international administration that is used via the Internet in buying and selling operations or converting them into currencies. Others are voluntarily accepted by those who deal with them." (Mohammedi, 2019, p 619)

It is also defined as "a currency that is available in digital or electronic form only and is not in physical form (intangible) and is processed using computers or electronic wallets."(Bou Abdallah & Elias, 2019, p 56) In the same sense, another defined it as "a digital currency of unknown origin, as it does not have a serial number or any other means that allows tracking what was spent to reach the seller or buyer, which makes it a popular idea among all defenders of privacy or sellers of illicit goods and merchandise, such as drugs, over the Internet.” (Al-Shammari, 2019, p 63)

It is also defined as “a monetary value stored on an electronic means that is prepaid and not linked to a bank account, and is widely accepted by others other than the one who issued it, and is used as a payment instrument to achieve various purposes.” (Al-Shafi’i, 2003, p1) Another defined it as “a currency that has the monetary characteristic transferred to it from paper money. It is not a stand-alone cash, but rather an intangible form of paper money, because its issuance involves converting the form of money from the paper form to the electronic form, and it is used as a tool for payments and settling accounts between customers and banks, Through electronic communication channels.” (Al-Bahouth, 2017, p 870)

2. 2 Characteristics of virtual currencies

Users obtain virtual currencies by mining them, purchasing them through exchanges, or selling goods or services and receiving their price in these currencies. These currencies are stored on the currency trading platforms themselves in the user's digital wallet, and their owner can convert them into another legal or virtual currency. These currencies derive their value from the supply and demand for them and from the market’s desire to buy and sell them, as they are not governed by a central authority and have no intrinsic value linked to gold or foreign legal currencies. (Farah, 2019, p 709)

The issuance and circulation of these currencies are controlled by three main parties: the miners, the individual and corporate users who wish to invest or deal in them, and the merchants who offer their goods and services over the Internet in exchange for these currencies. Accordingly, the distinctive characteristics of virtual currencies are:

First: It is a decentralized currency

The information program was designed in a decentralized manner, which allows transactions to occur between users without the need for the intervention of third parties such as banks or central trading systems such as the "SWIFT" system, which is widely used globally. (Hardo Center for Supporting Digital Expression, 2018, p 13)

Meaning that it is not subordinate to a central authority. This is in contrast to legal currencies, whose issuance and circulation are controlled by the central banks of countries, and are also distinguished by their reliance on a unique encryption technology based on electronic peering technology through peer-to-peer transactions on their trading platforms. (Fahd & Al-Aqidi, 2021, p 236)

This exposes money to real loss, as we see that when inflation occurs and a bank declares bankruptcy, the central bank intervenes to compensate the owners of the money for the losses they suffer as a result of this matter, while in virtual currencies this matter is non-existent, as there is no central bank that can compensate for the possible or expected losses. (Alloush & Awad, 2019, p 314)

Second: It is a global (cross-border) currency

It is known that these currencies have broken geographical barriers, and have provided the consumer with a large amount of cash at the end of the super-fast purchase process, as the money you want is transferred in less than seconds, regardless of the location of the sender and the recipient. There are no limits or restrictions, unlike the method Traditional banks take long periods, up to days. (Rabai, 2020, p 2490)

Virtual currencies are not linked to a specific location to be dealt with, as they are not subject to the authority of a state or central bank, and therefore no country can prohibit dealing with them because they are not subject to its authority or control, so they can be dealt with as if it were your local currency. (Hardo Center for Supporting Digital Expression, 2018, p 6)

Since virtual currencies can be accessed from anywhere in the world thanks to their decentralized, cross-border virtual system, it will be relatively useless for individual countries to undertake the issue of regulating these currencies, unless this is done according to similar principles and agreed upon among most countries, and in a way that enhances cooperation. The international collective in organizing the issue. (Farah, 2019, p 731)

Third: It has a very low cost

it is almost free, or sometimes it may be a negligible amount. (Farah, 2019, p 710) Unlike regular currencies, there are fees for using them. (Rabai, 2020, p 2491) The crypto-based currency exists as lines of instructions on the computer and is electronically signed. Digital currency can be used easily by downloading a program to manage a financial wallet on the user's personal computer, which is similar to online bank accounts, which are connected to the network to issue or receive payments in digital currencies.

The address of the recipient is then determined to complete the payment process in digital currency. Owning digital currencies means having the right to claim a Bitcoin address with a password and the right to transfer the value to another person without the need for an intermediary. (Alloush & Awad, 2019, p 310)

Fourth: It is a protected currency

users give great importance to the issue of security in encrypting the currency and the reliability of its trading platforms to avoid electronic risks, such as hacking their digital wallets, stealing their currencies from them, or even the sudden closure of platforms for trading their stored currencies, similar to what happened in America. (Farah, 2019, p 711)

Since every economic or financial transaction is saved in a block and distributed to millions of computers around the world, which makes the process of hacking is practically impossible, and the financial transaction takes place in front of the whole world, making attempts to manipulate it impossible. (Abu Salah, 2018, p 3)

The digital currency is built on the blockchain, which is a decentralized database, that is, a kind of ledger or ledger, that shows who owns what, running on thousands of computers. (Hardo Center for Supporting Digital Expression, 2018, p 12)

Fifth: Dealing with it is transparent

Virtual currencies are used by everyone with complete transparency and freedom, as the currency is transferred between different wallets, and all dealers acknowledge the existence of this money and the transfer of its ownership. (Zuhri & Al-Saeed, 2020, p 513)

The digital currency exists as an entry in an accounting system – a transparent, publicly open ledger called a blockchain – that records balances and transfers between private Bitcoin addresses. That is, the blockchain is a public record that includes all transactions related to the digital currency, meaning that at a given moment it shows which person owns how much digital currency.

Whenever a person performs a transaction with digital currency, it is entered into this register. Whenever a blockchain is completed, a new blockchain is automatically created that is linked chronologically to the old blockchain by including the latter’s identification code. (Al-Siddiq, 2021, p 454)

2. RISKS OF DEALING IN VIRTUAL CURRENCIES

Despite the features that virtual currencies enjoy, the most important drawback to them at present is their loss of legitimacy in many countries that have banned dealing with them, especially in light of their anonymous nature and the connection of some of their transactions to illegal activities. Cryptocurrencies with this description are vulnerable to illicit use many times over. It can be used as a way to launder money, avoid exchange control regulations, and engage in many criminal activities, such as tax evasion. Accordingly, we will divide this section into two parts. In the first section, we will discuss the risks of using virtual digital currencies as a means of money laundering, while the second section will be devoted to examining their use as a means of tax evasion.

3.1 Dealing in digital currencies as a means of money laundering

Credit and liquidity risks would destabilize their national economies and disrupt the structure of their public and private payments system, especially in the absence of a central supervisory authority for dealing with these currencies. In light of this reality, some countries find themselves unable to exercise effective control over their use or provide an effective mechanism to confront the legal and realistic challenges associated with their circulation. Cryptocurrencies of this description are twice as vulnerable to illicit use as fiat currencies and can be used as a route for money laundering and to evade exchange control and terrorist financing regulations. (Farah, 2019, p 723)

Digital currencies are encrypted currencies. Transactions are recorded and the identity of users is identified only through (virtual digital addresses) issued by digital currency dealing systems, which cannot reflect the true identity of the dealers, making them fertile ground for financing criminal activities related to the Internet. (Al-Siddiq, 2021, p 438)

With the emergence of virtual currencies, drug dealers have resorted to dealing in Bitcoin to complete drug deals, to ensure and ease the transfer of their money from Bitcoin and to the confidentiality of the transaction through sites that trade virtual currencies. The possibility of using Bitcoin in punishable money laundering operations has been raised. (Alloush & Awad, 2019, p 315) The lack of authority to control users of virtual currency helps to commit money laundering and drug trafficking crimes, it also contributes to fraud and financial fraud, and it also threatens monetary stability in countries. (Rabai, 2020, p 2493)

The European Union Financial Action Task Force has previously explicitly indicated that new payments using cryptocurrencies have increased the risks of money laundering and terrorist financing, as evidenced by the money laundering operations committed by the virtual currency trading platform and other criminal activities carried out by Liberty Reserve from Costa Rica in the period From 2006 to 2013, it laundered approximately six billion dollars for many cybercriminals whose activities included drug trafficking, filming child pornography, and hacking bank accounts..., and this platform had more than a million users and approximately 12 million transactions annually. (Farah, 2019, p 724)

3.2 Dealing in digital currencies as a means of tax evasion

The spread of dealing in these currencies deprives the state of its right to collect taxes, as the state cannot collect taxes on commercial operations related to virtual currencies. Using Bitcoin as a currency violates the laws and helps in tax evasion and other prohibited trades. (Rabai, 2020, p 2495)

Traders resort to dealing in virtual digital currencies because countries impose taxes on their profits, which leads to them evading paying taxes to the state, and it is difficult for governments to know them. The difficulty lies in tracking trading operations and knowing the identity of dealers, (Al Zaabi, 2018, p 56) due to the nature of trading in virtual currencies. Which increases the chances of tax and customs evasion, deepens the phenomenon of the hidden economy, and affects economic policies in general. (Al-Bahouth, 2017, p 906)

It is not possible to ignore the illegal use of virtual digital currencies, such as tax evasion, money piracy, theft of encrypted data, etc., without an integrated legal regulation that takes into account the nature of these currencies and all their legal, economic and social aspects about introducing amendments to the laws of money laundering, terrorist financing and tax evasion. The list is to prevent the use of virtual currencies in these criminal activities and to punish users who commit this, despite the lack of a regulating framework for virtual currencies. (Farah, 2019, p 730)

In addition to the difficulties facing countries in monitoring and tracking transactions that take place using virtual digital currencies, other difficulties arise in determining jurisdiction in the event of the relevant electronic crimes occurring. (Abdel Masih, 2021, p 2020) So, the spread of uncontrolled trading in virtual currencies disrupts the money transfer system and tax evasion, weakening the state’s power to preserve its currency and control and continue the movement of currency circulation. (Abu Salah, 2018, p 30)

CONCLUSION

After we explained through this study what is meant by virtual digital currencies, their characteristics, and the risks of using them as a means of money laundering and tax evasion, we concluded that combating any criminal activity resulting from the use of these currencies requires a legal organization that deals with them to prevent and combat them, whether it is related to money laundering or tax evasion, and accordingly, We list below several findings and suggestions regarding the topic as follows:

Findings

1- In reality, virtual currencies are considered a digital representation of a specific value, not affiliated with a central authority, and lacking the legal status of legal currencies.

2- Virtual digital currencies are illegal currencies, given that issuing currencies is the sovereign right of every internationally recognized country, as their circulation results in a violation of the country's laws that prohibit dealing with them because they are issued by unofficial and unidentified parties.

3- Virtual currencies are criticized for their lack of international support, especially in light of their anonymous nature and the connection of some of their transactions to criminal activities such as money laundering, terrorist financing, and tax evasion.

4- Iraq's failure to recognize virtual currencies despite the existence of trading platforms for these currencies as areas outside the law in light of the absence of national legal texts, which stand unable to deal with this phenomenon and avoid its dangers.

Suggestions

1- The need to explicitly stipulate by the Iraqi legislator prohibiting the establishment or operation of platforms for issuing or trading cryptocurrencies or digital money, or promoting them in Iraq at present.

2- The necessity of developing an integrated legal system to combat the use of virtual currencies in various criminal activities, regulating all their aspects, with an emphasis on the need to make appropriate amendments to the penal laws to deter and limit such activities.

3- The legislation related to money laundering, terrorist financing, and tax evasion must be amended, in a way that enhances transparency in detecting money laundering, terrorist financing, and tax evasion operations.

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