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How can Privacy considerations be consolidated with transaction transparency?

Computer Science and Private Law

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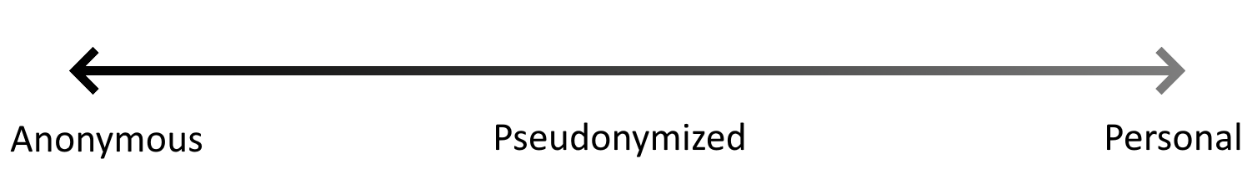
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1. Introduction
   1. Personal, anonymous and pseudonymized data

There are many types of data in our current world. Among these, the Information which concerns us as individuals the most is personal data. Personal data is defined by being linkable to a natural person through direct means. An example of this would be a person’s medical records.

After personal data there is pseudonymized data. This is information, that can be linked through indirect means to a natural person, such as Satoshi Nakamoto using a pseudonym while developing bitcoin. If we were to link the pseudonym to an identity, we would find out a lot of personal data about that individual. Data which cannot be linked to a person through any means is anonymous data and outside of most laws. [[1]](#footnote-1)

The scale of anonymous data is continuous, and data can land anywhere in between these three categories. In the case of cryptocurrencies, we are dealing with something in between Anonymous and Pseudonymized data.



* 1. UTXO vs Account Based Blockchains

UTXO stands for unspent transaction output. Bitcoin was the first cryptocurrency to employ UTXO based transactions. A real-world example of this would be the use of bank checks. On a bank check you can write any amount but with a check you can either use all the money on it at once or none of it. The only way to incrementally use a check would be to use all of it and then obtain a new check in return with a smaller amount. UTXO based transactions works similarly. Each UTXO contains a specific coin amount and for a transaction you can use multiple UTXO’s and output the combined value to multiple receivers, who each get their own UTXO.

On the other hand, you have, account-based transactions which are most famously employed in Ethereum. In account-based cryptocurrencies each account has an address and a balance. When transferring money, you need the other persons account address and given an amount your balance decreases and the destination account balance increases. This simplifies transactions and makes it easier to use wallets, collect all your assets in one place. Furthermore, it is easier to implement smart contracts in account-based transactions and it allows you to save storage space since addresses are often reused. Sadly, it also creates a single point of failure. If you leak a public key in UTXO based cryptocurrencies, you admit to a single or a few transactions. If you however leak a public key in an account-based cryptocurrency, you leak your entire transaction history.

1. Privacy in Distributed Ledgers
   1. Different Cryptocurrencies

While banks and other trusted financial institutions protect their user’s privacy by releasing as little information as possible, distributed public ledgers do not have that possibility. They must be accessible to everyone, and no data can be hidden. What instead can be hidden is the information held by the data. This is done through cryptographic means. Notable cryptographic methods include the use of public and private keys, zero knowledge proofs, optimistic proofs, and many more.

* + 1. Bitcoin

Bitcoin was the first cryptocurrency developed by Satoshi Nakamoto in 2008. Already back then privacy was a big concern and hence privacy considerations were regarded, while creating bitcoin[[2]](#footnote-2). Instead of using personal data such as one’s name, address, and birthday to make a transaction, bitcoin uses public and private keys to receive and create UTXO’s.

An example of how bitcoin is not anonymous would be the fact that 1.1 million bitcoins have been linked to Satoshi Nakamoto[[3]](#footnote-3). Although all the best privacy measures were used, we still now know that the net worth of Satoshi Nakamoto is equal to around 47 billion USD as of April 2022. If his or her real identity were to leak, it is obvious how this would be personal information.

The method used in the mentioned report cannot be applied to every person but if anyone ever leaks their public keys, all transactions done with those keys become linkable to that person.

Considering the right to be forgotten[[4]](#footnote-4) the permanent and public nature of bitcoin is (in direct violation of this law).

**Address Reuse**

It is possible to only use one address forever but that would be against all recommendations. In conclusion bitcoin is as private as you make it, so if you employ good practices and never reuse wallet addresses and never leak your own information it will be very close to anonymous but if you do not follow these principles, it will quickly become pseudonymous.

**Bitcoin Mixers**

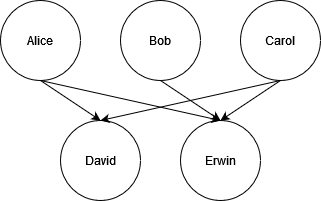
A way to further increase privacy in the bitcoin network is to use mixers. Mixers take many UTXO as input from different people and returns different

* + 1. Privacy Coins

Privacy coins are cryptocurrencies which hide transaction details from the public[[5]](#footnote-5). Privacy coins are usually more computationally heavy, require more storage space and are more complex in general, but these downsides are outweighed by the privacy they provide.

* + - 1. Monero

Monero uses ring signatures to hide transactions[[6]](#footnote-6). You are forced to use one-time keys as reusing a public key more than once causes rings to be linked and the transaction to be marked as invalid. This stops double spending attacks and also increases privacy.



You can see that both David and Erwin receive money, but who exactly send them the money is unknown, since each transaction requires multiple utxo’s as inputs.

* + - 1. Z-Cash

Z-cash

Is split up into two address types of transparent t-addresses and private z-addresses. It follows that four types of transactions can happen in the z-cash network. T-t

Z-cash uses a cryptographic method known as zero knowledge proofs, in which you prove you know a secret without sharing the secret.

A simple example of a zero-knowledge proof would be Alice proving to Bob that she knows the code to a safe. Alice could show the safe being closed, then secretly enter the code, and show it being open to Bob. This way Alice has proven that she knows the safe combination without revealing it to Bob.

In the case of Z-cash however this is done with complex mathematics.

It is important to note that the founders own 2.1 million coins with there being a maximum of 21 million coins. They hold more than 10% of the z-cash market, which puts the distributed nature of the ledger into question.

1. Legal Ramifications
2. Conclusion

Although privacy seems to be weaker in bitcoin it all depends on how the user decides to use the service. If they reuse addresses and make their addresses public, then no amount of cryptography can save their privacy. However, the announcement of wallet addresses does not happen on the blockchain itself. It happens on other platforms. UTXO based blockchains have no means of deanonymizing a person. The deanonymization happens elsewhere and so the legal ramifications should happen there as well?

Selbständigkeitserklärung

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Ort, Datum Eigenhändige Unterschrift

1. Art. 4 GDPR, Definition: https://gdpr-info.eu/art-4-gdpr/ [↑](#footnote-ref-1)
2. [↑](#footnote-ref-2)
3. https://bitslog.com/2013/04/17/the-well-deserved-fortune-of-satoshi-nakamoto/ [↑](#footnote-ref-3)
4. Art. 17 GDPR [↑](#footnote-ref-4)
5. [↑](#footnote-ref-5)
6. [↑](#footnote-ref-6)