Corporate and Commercial Newsletter:

Cryptocurrencies

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HOLMAN WEBB – Australia

The cryptocurrency revolution is well underway and Australia is no exception. However, with the introduction of a new trading medium comes the question of regulation. Below we take a brief look of Australia's current cryptocurrency regime.

Current regulation

Parliamentary inquiry

In 2015 a parliamentary inquiry assessed the current state of cryptocurrency and identified a number of regulatory opportunities and risks. Of particular concern to the inquiry was the 'pseudo-anonymity', price volatility and tax evasion that may occur.

The inquiry published a report which focused on the areas of tax treatment, financial regulation and law enforcement. This report has not led to a standalone virtual currency statute, or wholesale changes to existing legislation. Rather, it has mainly been a case of applying existing laws to deal with the new issues raised by cryptocurrency.

Tax

The general principle is that cryptocurrency is treated like any other asset. This means:

- The sale of cryptocurrency can create a capital gains tax liability, unless the usual exemptions apply;
- A capital loss may apply to stolen or 'lost' cryptocurrency;
- Cryptocurrency will be deemed as income if received in the course of business for goods or services;
- Payments to employees in cryptocurrency are likely a fringe benefit; and
- Transactions must be adequately recorded.

Calculating capital gains tax liability may not be easy. Apart from the day to day fluctuations of the particular cryptocurrency, the 'market value' may be substantially less than the listed value at any given time if the currency is difficult to convert. Also, how will the 'personal use' exemption to Capital Gains Tax be applied for a small investment which jumps in value exponentially? There are applications for private rulings on these issues that are currently being considered by the Australian Taxation Office. While obviously these issues need to be considered on a case by case basis, given the increase in cryptocurrency investment we are likely to see further broad principles develop in the near future.

Capital raising

The primary discussion in this area has been whether initial coin offerings (ICOs) amount to 'financial products'. The definition of 'financial product' in the Corporations Act 2001 (CA) focuses on facilities or arrangements that involve a financial investment or risk. If this definition applies, the ICO process becomes subject to the range of disclosure and licensing obligations on the issue and sale of securities, options and other traditional financial products set out in the CA.

The view of the Australian Securities and Investment Commission (ASIC) is that an ICO could involve a financial product. The question is whether the coin or token on offer meets the standard requirements of a financial product; for example, does the coin give the purchaser rights akin to a security? Is the currency pooled and used for a common enterprise, like a managed investment scheme? If so, the ICO will be subject to the CA obligations like any other capital raising.

In 2018, ASIC has been active in the ICO space. According to a media release from September, ASIC has issued administrative stop orders to prevent a number of ICOs completing due to the absence of the required licences and inadequate disclosure. It's also important to note even if an ICO does not involve a 'financial product', the prohibition on misleading or deceptive conduct will continue to apply.

Law enforcement

Since the inquiry, there have been changes made to the Commonwealth legislation dealing with anti-money laundering and counter terrorism financing. These changes mean that all 'digital currency exchanges' – being those which exchange cryptocurrency for money or vice versa – must be registered with AUSTRAC. All applicants must provide backgrounds information on their operations, including the volume and type of digital currency traded. AUSTRAC can impose conditions on

In addition, digital currency exchanges will now be subject to many of the obligations on reporting entities under the legislation, including:

- Adopting a compliance program to minimise the risk of money laundering or funds used in terrorism;
- reporting suspicious matters;
- reporting various types of transactions, including those with a value of $10,000 or more; and
- generating and retaining records.

These changes are designed to reduce the risks identified by the parliamentary inquiry mentioned above. Time will tell whether they have the desired effect, however it's notable that Australia is one of the early adopters of this type of regulation.

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ARDENT ADVOCATEN – Belgium

1. (The lack of) regulation of cryptocurrencies in Belgium

Belgium, like most European countries, has no coherent or adequate legal framework to deal with the characteristics of cryptocurrencies. This is not a desirable situation as this leads to a lot of legal uncertainty.

According to André Henkes, a magistrate at the Court of Cassation, cryptocurrencies are to be seen as "virtual, decentralised and anonymous coins that are not supported by any government, state or other legal entity". However, the legal relevance of cryptocurrencies is increasing. Therefore there is a pressing need to create clear rules and to draw up appropriate legislation.

2. Qualification of cryptocurrencies in Belgium

a. Are cryptocurrencies money?

The magistrate at the Court of Cassation argues that cryptocurrencies are coins and that therefore they are linked with the concept 'money'. From an economic point of view however, he stresses that cryptocurrencies cannot be considered as money because their value is too volatile.

On the other hand one can also argue that cryptocurrencies are not only linked with the concept of 'money' but that they are actually to be seen as money as such. In the end money is primarily a medium of exchange and people can use cryptocurrencies to trade what they have for what they want. Moreover, cryptocurrencies do have a certain - albeit a very volatile – value.

b. Debt claims or virtual goods?

When it comes to property law and contract law there are various legal uncertainties as well. Cryptocurrencies could be qualified as virtual goods, but they can likewise be seen as claims. In criminal law this doubt causes troubles. Cryptocurrencies have characteristics of goods, but also of data. Therefore, it is possible for hackers to steal cryptocurrencies.

c. Seizure/forfeiture of cryptocurrencies?

This brings us to another question: is it possible to seize cryptocurrencies? Is it possible for a court to enforce a sentence of forfeiture of cryptocurrencies gained through illegal activities? Both questions have to be answered affirmatively. Already mid-January 2015 the first seizure of cryptocurrencies in Belgium took place. In 2017, two Belgian courts decided to forfeit cryptocurrencies that were owned by drug lords. Not very surprisingly the seized coin in all of these cases was the most notorious of its kind: Bitcoin. Nevertheless, it is also possible to seize any other coin like Ethereum, Ripple and so on. However, the seizure of cryptocurrencies also comes with various difficulties. The volatile character of cryptocurrencies makes it troublesome to determine the exact value of a set of seized coins, but also to decide when the time is right to sell

them. Therefore, the Belgian Minister of Justice, together with some specialists, is currently working on a system to sell seized cryptocurrencies.

d. Can I pay with cryptocurrencies in Belgium?

Paying invoices with cryptocurrencies in Belgium is, in general terms, possible. However, one, rather logical, requirement is necessary: the other party has to accept payments in cryptocurrencies as cryptocurrencies are not a legal means of payment under Belgian law. Some initiatives like the website www.gentbitcoinstad.be (focused on the city of Ghent) try to draw up a list of all merchants in the city who accept payments in Bitcoins.

However, most big companies will be quite reluctant to accept payments in Bitcoins or any other cryptocurrencies. In the end cryptocurrencies also form a source of questions and uncertainties on the accounting level. How can an accountant book Bitcoins? Most invoices come with an expiration date: how should a company try to remedy the ever fluctuating exchange rate of cryptocurrencies? …

It is crystal clear that a solid legal framework is inevitable: a coherent legal framework is needed and it will also be necessary to not limit this framework to cryptocurrencies. Attention should also be given to other applications of the blockchain technology like *smart contracts*.

3. Belgian tax treatment of cryptocurrency gains

The tax treatment of cryptocurrency gains used to be a rather uncertain topic in Belgium too. However, a ruling of the Belgian tax authorities at the end of December 2017 is certainly worth discussing and brought more clarity.

People who are buying and selling cryptocurrencies on a non-professional basis will have to pay 33% taxes on the added value that was created throughout the buying and selling process. This is especially striking when this regime is compared with the Belgian regime for shares. Added value on shares is, in general, not subject to taxation. Only when the buying and selling of shares has a speculative character, 33% tax on the added value will be due.

This implies that if someone who buys and sells cryptocurrencies succeeds in proving that his transactions did not have any speculative character whatsoever, the added value he or she has realised will not be subject to taxation. This may be the case when someone bought cryptocurrencies and held them for more than a year.

When someone trades cryptocurrencies on a professional basis he or she will have to pay so called *personal income tax* on the added value he/she has realised. Consequently, these people can be obliged to pay up to 50% taxes on the added value they have realised.

4. Conclusion

Cryptocurrencies in Belgium are characterised by a lot of legal uncertainty. This makes it very burdensome for anyone who is working in the legal world to come up with legally sound advice. Therefore it is necessary that both Belgium and Europe will come up with a good legal framework soon. This could certainly remedy most of the uncertainties and stimulate the use of advantageous new technologies linked to blockchain.

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KELLER – Denmark

Taxation of Cryptocurrencies in Denmark

Although the earliest cryptocurrencies were released almost a decade ago, legislation specifically aimed at regulating taxation of cryptocurrencies has yet to be implemented in Denmark. Instead, Danish tax authorities have relied on existing principles and legislation to determine how gains and losses are taxed.

PURCHASED AS IN INVESTMENT OR FOR OTHER PURPOSES

The legal status of cryptocurrencies in regards to taxation was established as early as 2014, in a decision where the Danish Tax Council determined that cryptocurrencies were not actual currencies, but assets. Gains and losses on cryptocurrencies were therefore, unlike traditional currencies, not subject to the Danish Gains on Securities and Foreign Currency Act, but were taxed in the same manner as regular private assets such as cars, furniture or paintings.

Under this act, gains on cryptocurrencies would only be taxable if the currency was purchased as an investment, in which case it would be taxed as regular personal income. This also meant that losses were only deductible at a lower rate than gains were taxed at.

If the cryptocurrency was purchased to be used as a medium of payment, or if it was purchased on the basis of a political, technological or ideological interest in the concept of cryptocurrencies, any gains would be tax free. Similarly, losses on cryptocurrencies would not be deductible under those circumstances.

Taxation of gains and losses on cryptocurrencies was therefore uncertain, as in each instance, it would have to be determined for which purpose the cryptocurrency was purchased. The legal status of gains and losses was only clear when trading occurred via financial instruments or when it was conducted by a company.

If instead of purchasing cryptocurrency directly and storing it in a wallet, a person traded cryptocurrency by way of financial instruments, for example by using CFDs to short cryptocurrencies, gains and losses (both realized and unrealized) would be subject to capital gains tax. Gains earned and losses incurred by companies trading in cryptocurrencies would be subject to the corporate tax rate of 22 %.

REVERSAL AND PRESENT REGULATION

The 2014 decision was modified in a decision made by the Danish Tax Council on 27 February 2018.

The case concerned a person who purported to have purchased a rather sizable holding of bitcoins out of a personal interest in the concept of cryptocurrencies. In its decision, the Tax Council described cryptocurrencies as purely electronic assets which, unlike other private assets

such as cars or paintings, have no practical application. Furthermore, they were described as being easily transferable.

On this basis, the Danish Tax Council found that the purchase had been made out of a personal interest in cryptocurrencies as well as for the purpose of investment.

A press release from the Danish Tax Council accompanying the decision stated that most if not all private bitcoin purchases henceforth would be considered investments and would therefore be taxed. Senior tax officials have since publicly commented that purchases of anything more than a minute amount of cryptocurrency, as well as any purchases of cryptocurrency in recent years, would be considered investments.

Since cryptocurrencies are still considered private assets rather than currencies, gains are taxed at a higher rate than losses can be deducted at. The lack of a reclassification of cryptocurrencies as actual currencies following the 2018 decision could signal a hostile stance on the side of the tax authorities towards cryptocurrencies, possibly based on the reasonable assumption that cryptocurrency trading could enable new forms of tax evasion. It remains to be seen if a reclassification will occur in the future, or if the present and rather unfavorable status quo for private trading of cryptocurrencies is here to stay.

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MUNDAYS – England

Regulatory Status of Cryptocurrencies in the United Kingdom

Although the UK is well-established as one of the leaders in Fintech innovation, and an attractive place to be for financial entrepreneurs, most commentators would say that in terms of cryptocurrency regulation in the UK, the country is not seen as a leader, and it remains an area that is largely unregulated.

In the UK, all activities encompassing the issues of equity and debt are regulated by the Financial Conduct Authority ("**FCA**"). The FCA's strategic objective is to ensure the seamless operation of relevant financial markets, and it achieves this objective by providing appropriate protection for consumers and investors, as well as by promoting effective competition in the markets.

However, the FCA has said that as cryptocurrency does not have a defined classification in the financial markets, they are not currently regulated by them provided they are not part of other regulated products or services. The FCA maintains that *"cryptoassets designed primarily as a means of payment or exchange would not generally sit within the scope of FCA authority"*. This is to be compared with the SEC and CFTC who play a major role in cryptomarket regulation in the US. Virtual currencies remain largely unregulated in the UK. One of the reasons for this is that, as things stand, experts do not believe the market in cryptocurrencies poses a severe enough threat to financial stability for cryptocurrency regulation to be urgent.

Having said that, the FCA issued a Consumer Warning on Initial Coin Offerings ("**ICOs**") on 12 September 2017, describing them as *"very high risk, speculative investments"* and stated that the majority of ICOs would be unregulated. However, the FCA will consider ICOs on a case by case basis as to whether regulated activities are involved.

The FCA also issued a Consumer Warning in relation to Contracts For Differences ("**CFDs**") or financial spreadbets on the value of cryptocurrencies on 14 November 2017. The FCA also described CFDs as *"extremely high risk"*. Unlike ICOs, the FCA does regulate CFDs. Therefore, firms offering CFDs must be authorised by the FCA. However, the FCA warned that only experienced and sophisticated investors should consider investing.

In February 2018, the formation of the UK's first trade body of crypto companies – CryptoUK – was announced with the stated aim of introducing self-regulation to the sector by introducing a code of conduct. It is not yet clear what the FCA's response to self-regulation will be (see last paragraph of this article regarding the taskforce by the FCA with the bank of England). However, CryptoUK will be able to lobby on the industry's behalf. Its remit will not, however, extend to ICOs. CryptoUK has urged the UK government to introduce regulation to avoid the UK falling behind the rest of the world.

One area where the FCA will step in is with cryptocurrency derivatives which are capable of being financial instruments under the Markets in Financial Instruments Directive II ("**MiFID II**").

The FCA however does not consider cryptocurrencies to be currencies or commodities for regulatory purposes under MiFID II. Firms conducting regulated activities in crypto-derivatives must, therefore, comply with all applicable rules in the FCA's Handbook and any relevant provisions in directly applicable European Union regulations.

It is likely therefore that dealing in, arranging transactions in, advising or providing other services that amount to regulated activities in relation to derivatives that reference either cryptocurrencies or tokens issued through an ICO, will require authorisation by the FCA. This will include cryptocurrency futures, cryptocurrency CFDs and cryptocurrency options. Any firm dealing in these transactions must ensure that it has the appropriate authorisation and permission to carry on regulated activity. If the firm is not authorised by the FCA and is offering products or services requiring authorisation, it is a criminal offence. Authorised firms offering these products without the appropriate permission may be subject to enforcement action.

Apart from the position in relation to derivatives, the UK's authorities have adopted a light regulatory touch but a positive approach towards virtual currencies for the block chain industry as a whole. The wait and see regulatory strategy has recently been made part of a sandboxing programme that allows for some form of cryptocurrency regulation in the UK, without actually having it. On 3 July 2018, the FCA announced that 29 companies had been accepted in the fourth regulatory sandbox, 11 of which are block chain-related startups. Regulatory sandboxes enable block chain startups to test their ideas, projects and solutions in the UK market under a controlled regulatory environment, and can be contrasted with the American model where no such scheme exists. When it comes to cryptocurrency exchanges and custodians, even though they are not under the FCA's oversight, the UK authorities intend to apply the anti-money laundering regulations in order to comply with the EU's fifth AML Directive.

Along the same lines, the UK Treasury has revealed their intentions to regulate cryptocurrency traders, requiring them to abide by KYC regulations and disclose their identities as well as report suspicious activities. This will obviously raise the standards within this field. Concerns have been raised over the volatile nature of cryptocurrencies, the potential for scams and their use in illegal activities, such as money laundering or funding terrorism.

In practice, most banks in the UK typically refuse support to virtual currency related transactions and businesses. Many feel this is detrimental to the still-developing block chain industry in the UK.

A number within the financial industry feel that the global cryptocurrency industry is gaining new grounds and the UK authorities are falling behind and are under pressure to produce a comprehensive strategy towards virtual currencies as soon as possible. The rest of the EU are currently ahead in terms of their legislative support for virtual currency related projects, and in the midst of Brexit negotiations, crypto-firms will need some very compelling reasons to choose the UK over the EU.

At the time of writing, an inquiry was launched by the Treasury Committee into digital currencies to look at what form regulation could take. The FCA has also put together a cryptocurrency regulation task force in association with the Bank of England. No doubt recommended guidelines and proposals for regulation will be coming out of these initiatives.

This article is written for guidance only and should not be relied for the purpose of making any decisions or advising any third party in relation to cryptocurrencies. For more information please contact David Irving (David.irving@mundays.co.uk)

EUGENEFCOLLINS

EUGENE F. COLLINS - Ireland

Regulatory Status of Cryptocurrency - Ireland

Ireland does not have any specific laws regulating cryptocurrencies or virtual currencies and blockchain technology, however there is no prohibition either. Given that crypto/virtual currencies and blockchain technologies form part of the wider area of financial services, it may be that other aspects of financial services regulation in Ireland are applicable to these activities and in the absence of specific regulation of these activities, this would have to be considered on a case by case basis.

The Central Bank of Ireland (CBI) is the competent authority in Ireland for the regulation of financial services and within that remit includes areas such as payment services and electronic money. The extent to which cryptocurrencies will ultimately fall to be regulated will depend on the CBI's determination of its position on the status of cryptocurrencies as a currency, together with any EU wide regulatory developments. Such a determination has yet to be made by the CBI. To date the CBI has issued in December 2017, a document entitled "Alert on Initial Coin Offerings" (ICOs), in which it highlights the risks associated with investing in ICO's. The CBI also highlighted in a warning notice that these virtual currencies are not legal tender nor carry the protection of any CBI guarantee. However, also published on the CBI's website is a speech by the CBI's Director of Policy and Risk, Gerry Cross, on the topic of "Financial Regulation and Technological Change" in which he refers to analysis that the CBI has been carrying out on virtual currencies and their associated risks, particularly from a consumer prospective. The Director notes that depending on the specific classification under current regulatory framework, an ICO may be subject to an array of existing financial services legislation. He goes on to point out that there needs to be a balanced approach to any possible regulation in the area referring in particular to a speech by the Chair of the European Banking Authority in March 2018 where it was stated it was not currently clear that bringing virtual currencies within the regulatory regime would be the best approach.

The Irish Department of Finance issued a paper on virtual currencies and blockchain technology in March 2018 in which the Minister announced the creation of an internal working group to monitor further developments in this area. That is a work in progress and nothing further has been published by it yet. The Department's paper confirms that there are both risks and significant opportunities associated with these new technologies. The Minister also pointed out that the Irish Government's Financial Services Strategy encapsulated in the IFS 2020 strategy statement, recognises "the importance of Ireland as a global location of choice for specialist international financial services and Ireland is focused on building its strengths in talent technology, innovation and excellent client services" and highlights that "engaging with virtual currencies and block chain technology Ireland can be instrumental in creating a predictable and open blockchain eco system in Ireland and furthering that ambition." There is clear recognition that at Government level, development of virtual currencies is aligned with Ireland's IFS 2020 strategy and the Irish Government and the Central Bank are engaged in generally welcoming such development.

Possible Regulatory Implications

While there is currently no specific regulation governing virtual currencies, activity in relation to issuing and dealing in virtual currency needs to be assessed on a case by case basis to see what existing regulations may be impacted. Relevant issues to be considered include the following:

- Is the virtual currency a "transferable security" or a "financial instrument" such as would come within the meaning of such terms under the EU's Markets and Financial Instruments Directive (MiFID). If a cryptocurrency was considered a transferrable security then the issue of such may well bring it within the scope of securities laws regulations requiring, for example the publication of a prospectus prior to being offered to the public or requiring that the dealing in such currencies, obtain an authorisation as an investment firm under MiFID. As the definition of transferrable security is not exhaustive, the matter should be considered on a case by case basis to ascertain whether the virtual currency in question was a transferable security. As regards ICO's to date, ESMA has acknowledged that depending on how it is structured it may well fall outside the ambit of existing financial services regulation.
- There is a real risk that activities relating to the virtual currencies may fall within the ambit of issues arising under the Payment Services Directive and generally the regime applicable to money transmission. This could arise if the virtual currency was transacted on a platform such that the activity was a regulated activity of money remittance/transmission. There are exemptions under such existing legislation where the platform operator is a commercial agent, or the platform is viewed as a security settlement system. Again, any specific matter or proposal should be considered on a case by case basis.
- The application of Irish anti-money laundering regulation to virtual currencies has not been determined to date and in the event it is most likely that it would be linked to a large extent on whether the virtual currency was considered a "transferable security." The draft Fifth Anti-Money Laundering Directive (AMLD5) which must be transposed no later than the end of 2019, will impose new anti-money laundering requirements on virtual currency exchanges and custodians operating in Europe.
- Currently it is unclear as to whether virtual currencies would be an eligible asset for the holding by certain regulated entities such as UCITs or insurance companies and this will ultimately only be determined by EU Regulation. Currently they would not fall within the categories of eligible assets for these entities. Similarly, it is unclear whether they would be considered capable of being structured so as to come within the understanding of the term "Fund".

Latest Developments

The European Parliament published in July 2018, a paper entitled "Virtual Currencies and Central Banks Monetary Policy: Challenges Ahead". In its paper it concludes that while financial regulators may have concerns about this new technology, they must accept that they arise as a result of free business choices. Therefore virtual currencies should be treated by Regulators as any other financial transaction or instrument, which requires measures applicable to them, being proportionate to their market importance, complexity and associated risks. The authors of the paper recommend that regulations concerning virtual currencies be harmonised across EU jurisdictions, noting that that is far from the current situation, and that investments in virtual currencies should be taxed similarly to investments in other financial assets.

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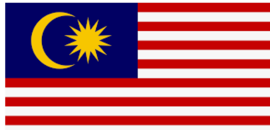

SEOW & ASSOCIATES – Malaysia

LOCAL REGULATIONS IN RESPECT OF CRYPTOCURRENCY IN MALAYSIA

Introduction

"You can't stop things like Bitcoin. It will be everywhere and the world will have to readjust. World governments will have to readjust" – John McAfee

The rising global phenomenon of cryptocurrency has gained much attention and acceptance throughout the world across all regions in the recent decade. This new type of digital money threatens to destabilize old monetary establishments all across the globe. The financial world was taken aback when the value of a Bitcoin, one of the most recognizable type of cryptocurrency to date, soared to the highest value of USD19,783.21 or RM78,647.50 per Bitcoin, in December 2017.

The English Oxford Living Dictionaries has defined cryptocurrency as *"a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank."*

In the simplest terms, a cryptocurrency is a digital or virtual currency that uses cryptography for security. As the definition suggests, cryptography enhances the security of cryptocurrency by making them difficult to counterfeit. This is essential as one of the central defining feature of a cryptocurrency is that it is not issued by any central authority. Unlike normal currencies which are controlled and regulated by a traditional centralized authority, cryptocurrency is decentralized, meaning no single entity or supervisory authority would be able to control or manipulate actions in the network. Cryptocurrencies are fully controlled by the users and computer algorithms.

Most cryptocurrency transactions are recorded on a digital public ledger called a blockchain. This technology ensures that transactional amounts are public but the identity of that person who sent that transaction is encrypted. Some types of cryptocurrency are able to achieve an even higher degree of anonymity. The anonymous nature and feature of cryptocurrency transactions makes it well suited for a host of illegal activities such as money laundering and terrorism funding.

In light of this issue, governments across the world have noted the rise of cryptocurrency and have attempted to place regulatory measures to counter the potential possible illegal activities relating to or arising from the transactions taking place and it is interesting to note the how widely divided the many governments are in their view and stand on cryptocurrencies.

Singapore is one of the first countries to embrace cryptocurrency by imposing taxes on the exchanges. Singapore deems Bitcoin as 'not legal tender' although the exchanges are legal and fall under the purview of the Monetary Authority of Singapore. The regulators in Singapore are well-informed and more transparent about their views on blockchain and cryptocurrency and this in turn facilitates more crypto-transactions. Under Singapore law, any cryptocurrency exchanges

which operate in Singapore must comply with anti-money laundering and counter financing of terrorism requirements.

In Thailand, the cryptocurrency industry is booming with Thai regulators introducing a new regulatory framework to control and regulate cryptocurrency. Known as the Digital Asset Business Decree, it serves to define both cryptocurrencies and digital tokens. The Thai government has also amended their local tax law to encompass the taxation of cryptocurrency exchange.

In Indonesia, the futures market regulator has chosen to regard cryptocurrencies as commodities under the preview of the Futures Exchange Supervisory Board. In addition, the new regulatory framework will cover crypto exchanges and other digital businesses.

In Malaysia, legal developments concerning cryptocurrency are still at an early stage and are not as advanced as compared to its neighboring jurisdictions as the Malaysian regulatory authorities have taken an exceedingly cautious approach towards cryptocurrency as a whole.

Legal Regulations in Malaysia

Section 20 of the Central Bank of Malaysia Act 1958 provides that, "*The Bank shall have the sole right of issuing notes and coin throughout Malaysia and neither the Government nor the Government of any State nor any public authority, or banking institutions or other financial institutions, or other institution or persons shall issue currency notes, bank notes or coin or any documents or tokens payable to bearer on demand being documental tokens which, in the opinion of the Bank, are likely to pass as legal tender.*" By virtue of this provision, it is clear that digital currencies are not recognized as legal tender in Malaysia.

Although the Central Bank of Malaysia Act 1958 has been repealed by the Central Bank of Malaysia Act 2009, Part III "Currency" of the Central Bank of Malaysia Act 1958, which covers section 20, continues to remain in force.

This was further confirmed by Bank Negara Malaysia ("**BNM**") in their policy document entitled "Anti-Money Laundering and Counter Financing of Terrorism Policy for Digital Currencies (Sector 6) ("Policy"). The Policy came into immediate effect on 27 February 2018. The Policy aims to ensure that effective measures are in place against money laundering and terrorism financing risks associated with the use of digital currencies and to increase the transparency of digital currency activities in Malaysia. Reporting obligations on digital currency transactions are being put under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 ("**AMLA**").

Reporting institutions conducting cryptocurrency exchanges are also required to conduct customer due diligence ("**CDD**") on all customers and the persons conducting the transaction when the reporting institution establishes business relationship with customer and when the reporting institutions have any suspicion of money laundering or terrorism financing.

This Policy is applicable to all reporting institutions, with or without physical presence in Malaysia in carrying out activities pursuant to Paragraph 25 of the First Schedule AMLA which states:-

"(a) activities carried out by any person who provides any or any combination of the following services: (i) exchanging digital currency for money; (ii) exchanging money for digital currency; or (iii) exchanging one digital currency for another digital currency, whether in the course of carrying on a digital currency exchange business or otherwise."

It must be noted that BNM has stated that individuals would also be considered a reporting institution if the individual carries out activities as listed out in Paragraph 25 of the First Schedule AMLA.

All reporting institutions are required declare their details to the BNM and are not permitted to represent themselves as an entity authorized, endorsed or licensed by the BNM, or in any way create a legitimate expectation that its activities are regulated by the BNM.

Under the Policy, reporting institutions must take appropriate steps to identify, assess and understand their risks in relation to their customers, countries or geographical areas and products, services, transactions or delivery channels. In the assessment of these risks, the following processes are required to be in order by the reporting institutions (a) documenting their risk assessments and findings; (b) considering all the relevant risk factors before determining what is the level of overall risk and the appropriate level and type of mitigation to be applied; (c) keeping the assessment up-to-date through a periodic review; and (d) having appropriate and clearly defined mechanisms to provide risk assessment information to the supervisory authority.

Besides that, reporting institutions must also conduct risk profiling on their customers. The Policy states that the following factors must be considered in profiling the risk of its customers; (a) customer risk (e.g. resident or non-resident, type of customers, occasional or one-off, legal person structure, status as PEP, occupation); (b) geographical location of business or country of origin of customers; (c) the products, services, transactions or delivery channels (e.g. cash-based, face-to-face, non face-to-face, domestic or cross-border); and (d) any other information suggesting that the customer is of higher risk.

Reporting institutions are required to conduct CDD when the reporting institution establishes business with a customer and when the reporting institutions have any suspicion of illegal activities. This requires reporting institutions to identify the party to the transaction, verifying and also to identify any person purporting to act on behalf of a party, identify the beneficial owner and to identify the purpose of the business relationship.

In this regard, the following confidential information such as a full name, national registration identity card, residential or mailing addresses, date of birth and purpose of the transaction will be needed in a cryptocurrency transaction for individuals. In cases of a non-face-to-face business relationship, a reporting institute can accept any other official documents bearing the photograph of the customer or beneficial owner, as the case may be, provided that the reporting institution is satisfied with the authenticity of the documents which contains the necessary, required information.

For customers that are legal persons, reporting institutions are required to understand the nature of the customer's business, its ownership and control structure. Reporting institutions are required to identify the customer and verify its identity through the following information: (a) name, legal form and proof of existence, such as constitution/certificate of incorporation/ partnership or any other reliable references to verify the identity of the customer; (b) the powers that regulate and bind the customer such as directors' resolution, as well as the names of relevant persons having a senior management position; and (c) the address of the registered office and, if different, a principal place of business.

Failure to complete the CDD requirements, will result in the reporting institution being unable to perform any cryptocurrency transaction and may also result in enforcement action being taken

under AMLA against the offending reporting institution including its directors, officers and employees for any non-compliance.

All of the relevant records including any accounts, files, business correspondence and documents relating to transactions, including those obtained during the CDD process to verify the identity of customers and beneficial owners, and results of any analysis undertaken must remain maintained up-to date for a period of at least six (6) years or longer in cases where there on-going investigations or court cases.

The Policy also requires every reporting institution to have in place an adequate management information system (MIS), to complement and support its CDD process. The MIS is required to provide the reporting institution with timely information on a regular basis to enable the reporting institution to detect irregularity and/or any suspicious activity.

Conclusion

While cryptocurrency appears at glance to be a well-established virtual currency system, there are still no uniform international laws that regulate cryptocurrency. BNM has stated that it intends to review the Policy within five (5) years from the date of issuance of the BNM's last review, and where necessary, amend or replace the Policy. Moving forward, any involvement in digital currencies in Malaysia must be undertaken with care and consideration taking into account BNM's stand that digital currencies are not legal tender in Malaysia. Parties interested in any form of involvement in cryptocurrency must carefully evaluate the risks associated with dealings in digital currencies until new detailed regulations are properly introduced in Malaysia.

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MARIF UGURLU – Turkey

REGULATION STATUS OF CRYPTOCURRENCIES IN TURKISH JURISDICTION

In recent years, the significant rise of cryptocurrencies such as Bitcoin, Litecoin etc. has encouraged people around the world to invest, or to consider the potential gains tendered by them. Cryptocurrencies' network integrated on Blockchain which is a shared public ledger where all confirmed transactions are included. Blockchain's integrity is enforced with cryptography, making the system anonymous and preventing possible third parties' attempts. On the other hand, successful hacking attempts such as the decentralized autonomous organization showed us that neither the schemes built around cryptocurrencies nor the exchanges, where the key pairs granting access these cryptocurrencies are stored, are secure. Moreover there are also several potential risks surrounding cryptocurrencies which are mostly known as a matter of public; money laundering, terrorist financing, unpredictability, excessive volatility, and the presumptive loss of established financial players. There is no internationally recognized authority or instrument regulating cryptocurrencies, thereby national regulatory authorities are trying to address this problem all by themselves, at least for now. Whereas certain countries such as United States, Canada and many others prefer to establish a regulatory framework for cryptocurrencies, some other countries define cryptocurrencies as illegal.

Although Turkish legislations still remain silent regarding cryptocurrency in 2018 and today, there are no legal regulation prohibiting the use of cryptocurrencies or accepting cryptocurrencies as a legal method of payment. However, there are some opinions and ideas stated and expressed by several governmental agencies which at least show that there may be a development in that regard in the future. The press releases and the reports presented by these agencies, may guide people on this issue.

Within the scope of the current monetary legislations in Turkey, corporations that seek to operate in the electronic payment system business have to act in compliance with the Law on Payment and Security Settlement Systems, Payment Services and Electronic Money Institutions numbered 6493 (the "**Law No. 6493**"), published in the Official Gazette dated 27.06.20132 and entered into force, regulates the procedures and principles of payment and security settlement systems, payment services, payment institutions and electronic money institutions. Under Article 3 of the Law No. 6493, a definition of electronic money is made as follows; "*Electronic money: Monetary value issued on receipt of funds, stored electronically, used for the purpose of making payment transactions described in this Law and accepted as a payment instrument by legal person and entities other than the electronic money issuer*".

Moreover, the first paragraph of the Provisional Article 2 of the Law No. 6493 "*(1) The system operators active as of the date at which this Law becomes effective are obliged to adapt their systems to this Law within a period of one year following the publication of the related regulation the publication of the related regulation by the Bank under the scope of this Law and to apply to the Bank for obtaining necessary permissions.*" states that any electronic currency shall be used in the system shall be issued by the institutions authorized by The Banking Regulation and Supervision Agency ("**BRSA**") in accordance with the Law No. 6493. Since current

cryptocurrencies in the global market are not issued by authorized institutions under the Law No. 6493, they are not considered as electronic payment instruments under Turkish legislation.

In the press release of BRSA numbered 2013/32 dated 25 November 2013, it was expressed that Bitcoin and similar cryptocurrencies could not be considered as an electronic currency in terms of Law No. 6493. The press release also informs the public of potential risks arising from use of cryptocurrencies by indicating following; "*the lack of identification of the parties in operations realized using Bitcoin and other similar virtual currencies create a suitable environment for these virtual currencies to be used in illegal activities. Moreover, Bitcoin has risks due to its market value which may be extremely volatile, or it may be stolen from digital wallets or get lost or may be used illegally outside the owners' knowledge; but also it is vulnerable to risks arising from the operational errors or from the abuse of malignant vendors due to irreversible nature of the transactions.*"

In addition the press release of BRSA, another research on the cryptocurrencies and Bitcoins was conducted by the Research Department of the Capital Markets Board of Turkey ("**CMB**") and the report was published in December 2016. Although the research report of the CMB repeats potential risks mentioned in the press release of BRSA and to highlights taxation issues of cryptocurrencies transactions in Turkish jurisdiction, CMB also provides positive approaches in terms of reliability of Bitcoin system, financial realities of supply and demand rule behind the valuation of Bitcoins in the market, availability for potential changes in order to secure identification for intermediary currency instructions and to express it will become very important and disruptive in the near future. Considering these CMB's positive opinions, the research report can be also considered as important indicator in order to have better understanding of current approach to use of cryptocurrencies.

Finally, the Suspicious Transaction Guideline[1] (Banks) prepared by the Presidency of the Financial Crimes Investigation Board ("**FCIB**") of the Ministry of Finance, considers "*transfer of funds from costumer accounts to accounts of intermediaries trading Bitcoin for the purpose of purchasing Bitcoins*" as a form of suspicious transaction and obliges banks to inform FCIB of such transactions. The reason for this obligation is the fact that parties of Bitcoins' transaction, as it is highlighted in the press release of BRSA, cannot be identified and it is difficult to provide a control on such transaction by government authorities.

In conclusion, it may be accepted that Turkish government currently stands as an observer of this field. In the light of above, we may conclude that the government had a negative attitude to cryptocurrencies and block-chain environment previously, but day by day with the recent monetary problems related to the foreign currency and global trends helped the government to change their attitude towards to positive way such as announcement of "Turcoin"[2]. As it may be interpreted from the explanations above, the regulatory framework regarding cryptocurrencies is extremely uncertain in Turkish Legislation which may be considered as a good thing since the lack of regulation creates an environment in which innovative applications can incubate or negative thing since legal securities have not provided yet. We believe that the Turkish government and governmental institutions will announce new regulatory framework on use of cryptocurrencies in Turkish financial market.

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[1] Turkish Version of the Suspicious Transaction Guideline
[2] http://www.hurriyetdailynews.com/turkish-cryptocurrency-turcoin-revealed-as-ponzi-scheme-133458

CONNER & CO – Russia

Regulatory status of cryptocurrencies in Russian Federation.

Despite the fact that there is no effective legislation covering cryptocurrency in the Russian Federation, the following draft bills are now going through the legislative process:

- a bill “On Digital Financial Assets”;
- a bill on crowdfunding; and
- draft amendments to the Civil Code

From an expert perspective, proposed legislation makes it almost impossible to conduct an ICO (or Initial Coin Offering) and / or the transaction of digital assets, in the way in which we would usually imagine it. Although the proposed legislation does not directly prohibit crypto-assets (in fact, they even recognize a new form of goods “digital assets”), it contains sections that limit operations of these assets. For instance, ICOs would be required to raise funds only in so-called “fiat money” form, in non-cash form and to a nominee account of the ICO operator.

Further, cryptocurrency exchanges are to be limited and regulated. There are many articles in these three bills that contradict each other so most likely they will be amended, otherwise they would be extremely unhelpful. The bill “On Digital Financial Assets” (the “**DFA**”) expressly indicates a new object – cryptocurrency, which experts are hoping will have a positive influence on both business and legal practices in Russia. However, neither this bill nor any of the others seems to recognize international experience in this area. Under the DFA, serious restrictions on both crypto-related activities and crypto-transactions are implied. One of those restrictions obliges persons dealing in crypto to identify himself/herself in accordance with current anti-money laundering legislation. Another requirement is the obligation to register and operate an e-wallet with the help of the Russian DFA operator. Additionally, under the proposed legislation, it will be impossible to exchange cryptocurrencies or to buy tokens for cryptocurrency.

Amendments to the Civil Code recognize cryptocurrency as means of payment but on the condition that they will be further regulated by special legislation. Meanwhile, the Russian courts sometimes treat cryptocurrency transactions as deals involving a special kind of property. There is also a recent decision where crypto-assets were included in the amount of the debtor’s funds.

The tax authorities also seem to recognize the existence of cryptocurrency. In their official letter as of May 17, 2018, they stated that natural persons should count their income from crypto-transactions and send personal tax declarations unilaterally.

Summarising the above, despite the fact that Russian authorities admit the importance of crypto issues, that President Putin is keen that Russia becomes a major player in this area, and that the

Russian public are obsessed with crypto matters, the legislation mainly ignores International best practice in this area.

Conner & Company has worked on several ICOs, and has looked to the Isle of Man as a well-regulated, but flexible jurisdiction in which to handle them. Corlett Bolton, our Manx Cicero member, proved very helpful in providing contacts within the regulators to help with our work. Sadly though, these ICOs failed to raise the necessary funds.

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DUNNINGTON
BARTHOLOW & MILLER LLP
ATTORNEYS AT LAW

DUNNINGTON, BARTHOLOW & MILLER – United States

The ABCs of cryptocurrencies:

Cryptocurrencies are digital assets designed to work as a medium of exchange that use strong cryptography to secure financial transactions, control the creation of additional units, and verify the transfer of assets. Cryptocurrencies are an alternative, digital currency, and slowly their use is becoming more popular, mostly due to the fact that cryptocurrencies use decentralized control as opposed to other centralized digital currencies, e.g. Apple Pay, and central banking systems.

Cryptocurrency is an app built on top of Blockchain, which in turn is distributed ledger technology, that serves as a public financial transaction database that is used to record transactions across many computers. Such transaction records cannot be altered retroactively without the alteration of all subsequent blocks, and the consensus of the network, as the data that is input in the Blockchain cannot be removed. This allows the participants to verify and audit transactions in a much more cost-efficient way.

Cryptocurrencies under U.S. legislation:

In the United States, the Securities and Exchange Commission (SEC) is in charge of regulating the securities industry, enforcing the federal securities laws, and proposing rules regarding the stock and options exchanges, and other activities and organizations, including the electronic securities markets. Regarding cryptocurrencies, the SEC is aware of the impact they have on the current economic environment and has made several statements regarding their use and legality.

Companies and individuals are increasingly considering initial coin offerings (ICOs), one of the many forms of cryptocurrencies, as a seemingly faster and easier way to raise funds or participate in investment opportunities. At this juncture, the discussion revolves around whether or not and under what circumstances a cryptocurrency would constitute a "security." If a cryptocurrency were deemed to be a security, then the offer and sale of the cryptocurrency would be subject to the same SEC regulatory regime as is applicable to the offer and sale of other securities.

Section 2(1) of the Securities Act of 1933 (Securities Act) defines the term "security" broadly to include investment contracts, among other things. The essence of determining if a cryptocurrency token is to be viewed as a security comes down to the structure and substance of the transaction. A change in the structure of a securities offering does not change the fundamental determination

as to whether a security is being offered. Thus, replacing a traditional corporate interest recorded in a central ledger with an enterprise interest recorded through a Blockchain entry on a distributed ledger may change the form of the transaction, but it does not change the substance:

> *ICOs, or more specifically tokens, can be called a variety of names, but merely calling a token a "utility" token or structuring it to provide some utility does not prevent the token from being a security.*[1]

The applicability of federal securities laws to ICOs depends on the classification of the tokens and for this, the SEC makes an analysis using the Howey test. The Howey test refers to a 1946 U.S. Supreme Court case, SEC v. W. J. Howey Co., involving the Howey Company of Florida. The respondents, W. J. Howey Company and Howey-in-the-Hills Service, Inc., were Florida corporations owning large tracts of citrus acreage. The companies had planted about 500 acres annually, keeping half of the groves for themselves and offering the other half to the public "to help us finance additional development." Each prospective customer was offered both a land sales contract and a service contract, after having been told that it is not feasible to invest in a grove unless service arrangements are made.

The service contract, gave Howey-in-the-Hills Service, Inc., a leasehold interest and "full and complete" possession of the acreage. The company was accountable only for an allocation of the net profits based upon a check made at the time of picking. It was admitted that the mails and instrumentalities of interstate commerce were used in the sale of the land and service contracts and that no registration statement or letter of notification had ever been filed with the SEC in accordance with the Securities Act of 1933 and the rules and regulations thereunder.[2]

The Supreme Court determined that an instrument will qualify as an "investment contract" for the purposes of the Securities Act when:

> *[A] contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.*
>
> *The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial*

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[1] Securities And Exchange Comm'n, Statement on Cryptocurrencies and Initial Coin Offerings by Chairman of the SEC Jay Clayton (December of 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11

[2] *SEC v. W. J. Howey Co.*, 328 U.S. 293, 297 (1946)

whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value. [3]

The concept of a security embodies a flexible principle, capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.[4] Bearing this in mind, three prongs must be met according to the Howey test:

1. An investment of money;
2. In a common enterprise;
3. With an expectation of profits; predominantly from the efforts of others.

The SEC has followed the Howey test and the malleable definition of securities before U.S. Courts to find that ICOs are in fact securities and should be registered, making way for indictments and sanctions imposed on those promoting them. More recently in United States v. Zaslavskiy, the Court looked into whether an indictment due to failure to register a security could be made regarding the sale of REcoin and Diamond, promoted by Zaslavskiy as a new virtual "currency." REcoin provided investors a financial platform through which people could convert their savings into real estate-backed currency for the potential of high returns to protect their earnings from inflation, they also launched a promotional website for REcoin, where they posted an informational "white paper." According to the REcoin White Paper, investors could change their money into a "more stable and secure investment: real estate," which grows in value.[5]

The Court analyzed the facts at hand under all three prongs of the Howey test, "whether a transaction or instrument qualifies as an investment contract is a highly fact-specific inquiry."[6]

1. First, the facts alleged demonstrate that individuals invested money (and other forms of payment) in order to participate in Zaslavskiy's schemes.[7]
2. Second, both REcoin and Diamond constituted a "common enterprise." In the Court's view, REcoin and Diamond profits would be distributed to investors pro-rata—given that investors were promised "tokens" or "coins" in exchange for, and proportionate to, their investment interests in the schemes.[8]

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[3] *SEC v. W. J. Howey Co.*, 328 U.S. 293 301 (1946)
[4] *Ibid. at 299*
[5] *U.S. v. Zaslavskiy*, 17 CR 647 (RJD), 2018 WL 4346339, at *1 (E.D.N.Y. Sept. 11, 2018)
[6] *U.S. v. Zaslavskiy*, 17 CR 647 (RJD), 2018 WL 4346339, at *4 (E.D.N.Y. Sept. 11, 2018)
[7] *U.S. v. Zaslavskiy*, 17 CR 647 (RJD), 2018 WL 4346339, at *5 (E.D.N.Y. Sept. 11, 2018)
[8] *U.S. v. Zaslavskiy,* 17 CR 647 (RJD), 2018 WL 4346339, at *5 (E.D.N.Y. Sept. 11, 2018)

3. Third, investors were led to expect profits in REcoin and Diamond to be derived solely from the managerial efforts of Zaslavskiy and his co-conspirators, not any efforts of the investors themselves.[9]

The Court ruled that the Indictment was sufficient under the Howey test and the case should proceed to trial. Not all cases are as crystal clear as Zaslavskiy's and the market is full of offerings that appear as attractive and easy opportunities to get money.

Issues With Cryptocurrency

The term cryptocurrency is used in a variety of contexts and, in response to this, the SEC has tried to warn the market by stating that while there are cryptocurrencies that do not appear to be securities, simply calling something a "currency" or a currency-based product does not mean that it is not a security.[10]

If a Token has been classified as a security, they may not be lawfully sold without SEC registration unless there is an available exemption. Such registration requires a substantial amount of disclosure and will result in the registrant incurring considerable expense.

The Securities Act's prohibition on the sale of unregistered securities applies to issuers, underwriters and dealers. The definition of "issuer" is broadly defined to include "every person who issues or proposes to issue any security" and "person" includes "any unincorporated organization."[11] The term "issuer" is flexibly construed, "[W]hen a person [or entity] organizes or sponsors the organization of limited partnerships and is primarily responsible for the success or failure of the venture for which the partnership is formed, he will be considered an issuer."[12] Thus, the prohibitions of Section 5 are broad enough to encompass "any person" who participates in the offer or sale of an unregistered, non-exempt security.[13]

In light of the recent increase in the use of cryptocurrencies, the SEC has been asked to change its definition of securities, thus providing more clarity for consumers, issuers and the market in general. However, the SEC Chairman Jay Clayton told media this year "We are not going to do any violence to the traditional definition of a security that has worked for a long time. We've been doing this a long time, there's no need to change the definition."[14]

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[9] *U.S. v. Zaslavskiy*, 17 CR 647 (RJD), 2018 WL 4346339, at *6 (E.D.N.Y. Sept. 11, 2018)

[10] Securities And Exchange Comm'n, Statement on Cryptocurrencies and Initial Coin Offerings by Chairman of the SEC Jay Clayton (December of 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11

[11] 15 U.S.C. § 77b(a)(4).

[12] *SEC v. Murphy*, 626 F.2d 633, 644 (9th Cir. 1980)

[13] *SEC v. Softpoint, Inc.*, 958 F. Supp 846, 859-60 (S.D.N.Y. 1997)

[14] *Federal judge says SEC rules apply to initial coin offering*, citing SEC Chairman Jay Clayton www.cnbc.com, https://www.cnbc.com/2018/09/11/federal-judge-says-sec-rules-apply-to-initial-coin-offering.html (Last Visited November 6th, 2018)

The cryptocurrency and ICO markets have grown rapidly, ranging from local, national to international and include an ever-broadening range of products and participants. The SEC has yet to approve for listing and trading any exchange-traded products holding cryptocurrencies or other assets related to cryptocurrencies.

The SEC recently gave the much-awaited ruling rejecting nine Bitcoin exchange-traded fund (ETF) proposals, noting that this rejection doesn't have anything to do with whether Bitcoin and Blockchain technology have utility or value as an innovation or an investment. The SEC found that none of the exchanges could satisfactorily demonstrate their ability to prevent fraudulent and manipulative acts and practices. The SEC also cited the inability of the exchanges to prove that Bitcoin futures markets are "markets of significant size" as the other reason to reject the proposals.

Conclusion:

Investor and counsel, beware. If rulings and opinions by the highest courts and authorities in the U.S. have taught us anything, it is to proceed with caution as the law in this area is unsettled and developing. Any proposed offering of a cryptocurrency needs to be analyzed by counsel using the Howey test in order to evaluate the risk of it being deemed to be a security under U.S. law.

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