



Blockchain & Cryptocurrency Regulation

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Australia

Peter Reeves & Georgina Willcock
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Government attitude and definition

The past few years have seen a sharp rise in the creation and use of cryptocurrencies in Australia, with companies such as Power Ledger and Havven raising millions through their Australia-based initial coin offerings (**ICO**). The Commonwealth Government of Australia (**Government**) has shared a broader commitment to facilitate growth and innovation within the technology and cryptocurrency sector whilst also increasing its regulatory involvement. To date, the Government has taken a largely non-interventionist approach to the regulation of cryptocurrency, allowing the landscape to evolve at a faster rate than its regulatory response. Australian law does not currently equate digital currency with fiat currency and does not treat cryptocurrency as “money”.

The Governor of the Reserve Bank of Australia (**RBA**), Australia’s central bank, stated during the 2017 Australian Payment Summit that the RBA has no immediate plans to issue a digital dollar akin to money. Terming it an ‘eAUD’, the Governor noted that the rise of new technology associated with cryptocurrencies has the capacity to challenge the role of traditional financial institutions with regard to payments, but that there is currently no public policy case for the RBA to issue an eAUD. Despite this, the Governor indicated that the RBA would be continuing to research this area and highlighted an ongoing study of the use of a central-bank issued digital dollar in relation to settlement arrangements.

While the Government has not intervened in cryptocurrencies and related activities to the extent that foreign government bodies have done in jurisdictions such as China or South Korea, there has been general clarification of the application of Australian regulatory regimes to the sector. For example, the Government recently passed the *Anti-Money Laundering and Counter-Terrorism Financing Amendment Act 2017 (AML/CTF Amendment Act)*, which brought cryptocurrencies within the scope of Australia’s anti-money laundering regime. This recognised the movement towards digital currencies becoming a popular method of paying for goods and services and transferring value in the Australian economy, but also posing significant money laundering and terrorism financing risks.

The Government has also been widely supportive of the new technologies in the cryptocurrency space. In November 2017, the Government awarded a \$2.57 million grant through its Smart Cities and Suburbs program to a project partly run by Power Ledger. The project is trialling the use of blockchain-powered distributed energy and water systems.

Cryptocurrency regulation

While there have been recent amendments to various pieces of legislation to accommodate the use of cryptocurrencies, these have predominantly focused on the transaction relationships,

such as the issuing and exchanging process, rather than the cryptocurrencies themselves.

Australia's primary corporate, markets, consumer credit and financial services regulator, the Australian Securities and Investments Commission (**ASIC**), holds the view that legislative obligations and requirements are technology-neutral. As such, the existing regulatory framework applies irrespective of the mode of technology that is being used to provide a regulated service. Therefore, while there hasn't been any legislation created to deal with cryptocurrencies as a discrete area of law, this does not hinder it from being captured within existing regimes under Australian law. A key example is that cryptocurrency which is characterised as a financial product under the *Corporations Act 2001* (Cth) (**Corporations Act**) will fall within the scope of Australia's existing financial services regulatory regime. This is discussed in more detail below.

Generally, to the extent that an entity implements blockchain or other distributed ledger technology (**DLT**) in supporting its cryptocurrency, there are various obligations with which to comply. In March 2017, ASIC released an information sheet (*INFO 219 Evaluating distributed ledger technology*), which provides guidance for businesses considering operating market infrastructure, or providing financial or consumer credit services using DLT. There is a general obligation that entities relying on technology in connection with the provision of a regulated service must have the necessary organisational competence, and must have in place adequate technological resources and risk-management plans. While the existing regulatory framework is sufficient to accommodate current implementations of DLT, as the technology matures, additional regulatory considerations will arise.

Various cryptocurrency networks have also implemented 'smart' or self-executing contracts. These are permitted in Australia under the *Electronic Transactions Act 1999* (Cth) (**ETA**) and the equivalent Australian state and territory legislation. The ETA provides a legal framework to enable electronic commerce to operate in the same way as paper-based transactions. Under the ETA, self-executing contracts are permitted in Australia, provided they meet all the traditional elements of a legal contract.

Sales regulation

The sale of cryptocurrency through an ICO is regulated by Australia's existing financial services regulatory regime. Core considerations for issuers are outlined below.

Licensing

Of particular concern to those dealing with cryptocurrencies is whether a cryptocurrency (including those offered during an ICO) constitutes a financial product and therefore triggers financial services licensing and disclosure requirements. Entities carrying on a financial services business in Australia must hold an Australian financial services licence (**AFSL**) or be exempt. The definitions of 'financial product' or 'financial service' under the Corporations Act are broad and ASIC has indicated in an information sheet issued in May 2018, *INFO 225 Initial coin offerings (Info 225)*, that cryptocurrency with similar features to existing financial products or securities will trigger the relevant regulatory obligations.

Within INFO 225, ASIC indicated that the legal status of cryptocurrency is dependent upon the structure of the ICO and the rights attaching to the coins or tokens. Depending on the circumstances, coins or tokens may constitute interests in managed investment schemes (collective investment vehicles), securities, derivatives, or fall into a category of more generally defined financial products, all of which are subject to the Australian financial services regulatory regime. Entities offering such coins or tokens will need to comply with the regulatory requirements under the Corporations Act which generally include

disclosure, registration and licensing obligations. An entity which facilitates payments by cryptocurrencies may also be required to hold an AFSL and the operator of a cryptocurrency exchange may be required to hold an Australian market licence if the coins or tokens traded on the exchange constitute financial products.

With the exception of China and South Korea, ASIC's regulatory guidance is consistent with the position of other international regulators. For example, the financial regulator in Hong Kong has outlined situations where cryptocurrency may be a financial product. ASIC has also recommended that companies wishing to conduct an ICO contact its Innovation Hub (discussed in detail below, 'Promotion and testing') for informal assistance. This reflects its willingness to build greater investor confidence around cryptocurrency as an asset class. However, to date there has not yet been a regulated financial product ICO in Australia.

Marketing

ASIC's recognition that an ICO may involve an offer of financial products has clear implications for the marketing of an ICO. For example, an offer of a financial product to a retail client (with some exceptions) must be accompanied by a regulated disclosure document (e.g., a product disclosure statement or a prospectus and a financial services guide) that satisfies the content requirements of the Corporations Act and regulatory guidance published by ASIC. Such a disclosure document must set out prescribed information, including the provider's fee structure, to assist a client to decide whether to acquire the cryptocurrency from the provider. In some instances, the marketing activity itself may cause the ICO to be an offer of a regulated financial product.

Under the Corporations Act, depending on the minimum amount of funds invested per investor and whether the investor is a 'sophisticated investor' or wholesale client, an offer of financial products may not require regulated disclosure.

Cross-border issues

Carrying on a financial services business in Australia will require a foreign financial services provider (**FFSP**) to hold an AFSL, unless relief is granted. Entities, including FFSPs, should note that the Corporations Act may apply to an ICO regardless of whether it was created and offered from Australia or overseas. Australia has cooperation (passporting) arrangements with regulators in foreign jurisdictions (including the United States of America and the United Kingdom), which enable FFSPs regulated in those jurisdictions to provide financial services in Australia without holding an AFSL. However, the passporting relief is currently only available in relation to the provision of services to wholesale clients (i.e. accredited investors), and the FFSP must only provide the services it is authorised to provide in its home jurisdiction. The passporting relief is currently under review ahead of its expiry in October 2018.

Foreign companies taken to be carrying on a business in Australia, including by issuing cryptocurrency or operating a platform developed using ICO proceeds, may be required to either establish a local presence (i.e., register with ASIC and create a branch) or incorporate a subsidiary. Broadly, the greater the level of system, repetition or continuity associated with an entity's business activities in Australia, the greater the likelihood that registration will be required. Generally, a company holding an AFSL will be carrying on a business in Australia and will trigger the requirement.

Promoters should also be aware that if they wish to market their cryptocurrency to Australian residents, and the coins or tokens are considered a financial product under the Corporations Act, they will not be permitted to market the products unless the requisite licensing and

disclosure requirements are met. Generally, a service provider from outside of Australia may respond to requests for information and issue products to an Australian resident if the resident makes the first (unsolicited) approach and there has been no conduct on the part of the issuer designed to induce the investor to make contact, or activities that could be misconstrued as the provider inducing the investor to make contact.

Design and distribution obligations and product intervention powers

The Government has released an *Exposure Draft of Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017* (the **Bill**), which may impact the way cryptocurrencies are structured and ICOs conducted in future. The Bill proposes to introduce new design and distribution obligations in relation to financial products as well as provide ASIC with temporary product intervention powers where there is a risk of significant consumer detriment. The new arrangements aim to ensure that financial products are targeted at the correct category of potential investors. At the time of writing, ASIC has yet to release guidance on the way it might interpret its powers, but it is highly likely to impact marketing and distribution practices in the cryptocurrency sector.

Consumer law

Even if an ICO is not regulated under the Corporations Act, it may still be subject to other regulation and laws, including the Australian Consumer Law set out at Schedule 2 to the *Competition and Consumer Act 2010* (Cth) (**ACL**) relating to the offer of services or products to Australian consumers. The ACL prohibits misleading or deceptive conduct in a range of circumstances including in the context of marketing and advertising. As such, care must be taken in ICO promotional material to ensure that buyers are not misled or deceived. In addition, promoters and sellers are prohibited from engaging in unconscionable conduct and must ensure the coins or tokens issued are fit for their intended purpose.

The protections of the ACL are generally reflected in the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**), providing substantially similar protection to investors in financial products or services.

ASIC has also recently received delegated powers from the Australian Competition and Consumer Commission to enable it to take action against misleading or deceptive conduct in marketing or issuing in ICOs (regardless of whether it involves a financial product). ASIC has indicated misleading or deceptive conduct in relation to ICOs may include:

- using social media to create the appearance of greater levels of public interest;
- creating the appearance of greater levels of buying and selling activity for an ICO or a crypto-asset by engaging in (or arranging for others to engage in) certain trading strategies;
- failing to disclose appropriate information about the ICO; or
- suggesting that the ICO is a regulated product or endorsed by a regulator when it is not.

ASIC has stated that it will use this power to issue further inquiries into ICO issuers and their advisers to identify potentially unlicensed and misleading conduct.

A range of consequences may apply for failing to comply with the ACL or the ASIC Act, including monetary penalties, injunctions, compensatory damages and costs orders.

Taxation

The taxation of cryptocurrency in Australia has been an area of much debate, despite recent attempts by the Australian Taxation Office (**ATO**) to clarify the operation of the tax law.

For income tax purposes, the ATO views cryptocurrency as an asset that is held or traded (rather than as money or a foreign currency).

Investors and holders of cryptocurrencies

The tax implications for investors or holders of cryptocurrency depends upon the intended use of that cryptocurrency. The summary below applies to investors who are Australian residents for tax purposes.

Investors in the business of trading cryptocurrencies (including funds) are likely to be subject to the trading stock provisions, much like a supermarket treats its goods for sale as trading stock. The gain and losses on the sale of cryptocurrencies will be taxable to such investors on “revenue account”.

Otherwise, the ATO has indicated that cryptocurrency will likely be a capital gains tax (CGT) asset. The gain on its disposal will be subject to CGT. Capital gains may be discounted under the CGT discount provisions, so long as the investor satisfies the conditions for the discount. It is unresolved in Australia whether cryptocurrencies are eligible to be CGT assets (and subject to the CGT discount) as a matter of law, considering most users of cryptocurrency have a profit-making purpose by way of selling their coins or tokens (i.e., they hold the cryptocurrency on revenue account).

Capital losses made on cryptocurrencies which are “personal use” assets are disregarded. This includes cryptocurrencies acquired or kept for personal use or consumption (i.e., to buy goods or services). Capital gains on personal use assets are only disregarded where the asset was acquired for less than A\$10,000.

Issuers of cryptocurrencies

In the context of an ICO, a coin issuance by an entity that is either an Australian tax resident, or acting through an Australian “permanent establishment”, will likely be taxable in Australia. The current corporate tax rate in Australia is between 27.5% and 30%. If the issued coins are characterised as equity for tax purposes, the ICO proceeds should not be taxable to the issuer, but all future returns to the token holders will be treated as dividends.

Australian Goods and Services Tax (GST)

Supplies and acquisitions of digital currency made from 1 July 2017 are not subject to GST on the basis that they will be input taxed financial supplies. Consequently, suppliers of digital currency will not be required to charge GST on these supplies, and a purchaser would not be entitled to GST refunds (i.e., input tax credits) for these corresponding acquisitions. On the basis that digital currency is a method of payment, as an alternative to money, the normal GST rules apply to the payment or receipt of digital currency for goods and services.

The term “digital currency” in the GST legislation requires that it is a digital unit of value that has all the following characteristics:

- it is fungible and can be provided as payment for any type of purchase;
- it is generally available to the public free of any substantial restrictions;
- it is not denominated in any country’s currency;
- the value is not derived from or dependent on anything else; and
- it does not give an entitlement or privileges to receive something else.

Enforcement

The ATO has recently announced the creation of a specialist task force to tackle cryptocurrency tax evasion. With the broader regulatory trend around the globe moving

from guidance to enforcement, it is likely that the ATO will also begin enforcing tax liabilities more aggressively.

In relation to mining cryptocurrency, the ATO has also released guidance in relation to how these activities will be taxed. This is discussed in ‘Mining’, below.

Money transmission laws and anti-money laundering requirements

In 2017, the Government passed the AML/CTF Amendment Act, which brought cryptocurrencies and tokens within the scope of Australia’s anti-money laundering and counter-terrorism financing (AML/CTF) regulatory framework. The amendments came into force on 3 April 2018 and focus on the point of intersection between cryptocurrencies and the regulated financial sector, namely digital currency exchanges. The Australian Transaction Reports and Analysis Centre (AUSTRAC) has outlined transitional arrangements for existing and new digital currency exchange (DCE) providers.

Broadly, DCE providers are now required to register with AUSTRAC in order to operate, with a penalty of up to two years’ imprisonment or a fine of up to A\$105,000, or both, for failing to register. Registered exchanges will be required to implement know-your-customer processes to adequately verify the identity of their customers, with ongoing obligations to monitor and report suspicious and large transactions. Exchange operators are also required to keep certain records relating to customer identification and transactions for up to seven years.

Bringing DCE providers within the ambit of the AML/CTF framework is intended to help legitimise the use of cryptocurrency while protecting the integrity of the financial system in which it operates.

Promotion and testing

Regulators in Australia have generally been receptive to fintech and innovation. While there are no programmes specifically promoting research and investment in cryptocurrency, both ASIC and AUSTRAC have established Innovation Hubs designed to assist fintech businesses more broadly in understanding their obligations under Australian law.

ASIC Innovation Hub

The ASIC Innovation Hub is designed to foster innovation that could benefit consumers by helping Australian fintech start-ups navigate the Australian regulatory system. The Innovation Hub provides tailored information and access to informal assistance intended to streamline the AFSL process for innovative fintech start-ups, which could include cryptocurrency-related businesses.

In December 2016, ASIC made certain class orders establishing a fintech licensing exemption and released *Regulatory Guide 257*, which details ASIC’s framework for fintech businesses to test certain financial services, financial products and credit activities without holding an AFSL or Australian credit licence by relying on the class orders (referred to as the regulatory sandbox). There are strict eligibility requirements for both the type of businesses that can enter the regulatory sandbox and the products and services that qualify for the licensing exemption. There are restrictions on how many persons can be provided with a financial product or service, and caps on the value of the financial products or services which can be provided. Businesses may only rely conditionally on the relief for 12 months.

The framework relating to ASIC’s regulatory sandbox has been subject to review. The Government recently closed its consultation on draft legislation and regulations outlining

the framework for an enhanced regulatory framework that allows businesses to test a wider range of products and services for a longer period of time. ASIC has also released a consultation paper suggesting that no changes to its existing fintech licensing exemption will be made.

Beyond this, ASIC has engaged with regulators overseas to deepen its understanding of innovation in financial services, including in relation to cryptocurrencies. ASIC and the United Kingdom's Financial Conduct Authority have signed an Enhanced Cooperation Agreement, which allows the two regulators to, amongst other things, information-share, refer innovative businesses to each regulator's respective regulatory sandbox, and conduct joint policy work. ASIC currently has either information-sharing or cooperation agreements with regulators in Hong Kong, Singapore, Canada, Kenya and Indonesia. ASIC is also a signatory to the IOSCO Multilateral Memorandum of Understanding, which has committed over 100 regulators to mutually assist and cooperate with each other, particularly in relation to the enforcement of securities laws.

AUSTRAC Innovation Hub

AUSTRAC's Fintel Alliance is a private-public partnership seeking to develop 'smarter regulation'. This includes setting up an innovation hub targeted at improving the fintech sector's relationship with the government and regulators. The hub will provide a regulatory sandbox for fintech businesses to test financial products and services without risking regulatory action or costs.

AUSTRAC has also implemented a new dedicated webpage providing information about the AML/CTF regime and AUSTRAC's role to assist businesses wishing to create a new financial service product or to understand their AML/CTF obligations. In its annual report for 2016–17, AUSTRAC noted that the webpage had been successful, garnering over 40 direct enquiries from entities developing innovative new approaches to providing "designated services" as defined under the *Anti-money Laundering and Counter-terrorism Financing Act 2006* (Cth) (**AML/CTF Act**). As discussed above, designated services now include the provision of DCE services, and consequently DCE providers may contact AUSTRAC through the webpage to understand their regulatory obligations.

Ownership and licensing requirements

At the time of writing, there are currently no restrictions on investment managers owning cryptocurrencies for investment purposes.

With respect to investment advice, where a cryptocurrency held is a financial product, investment advisors will be deemed to be providing financial product advice under the Corporations Act and will need to hold an AFSL or be exempt. ASIC has provided significant guidance in relation to complying with the relevant advice, conduct and disclosure obligations, as well as the conflicted remuneration provisions under the Corporations Act.

Against the backdrop of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* and the broader innovation agenda of the Government, Australia has seen a rapidly rising interest in robo-advice or digital advice models. The provision of robo-advice is where algorithms and technology provide automated financial product advice without a human advisor. For investment or fund businesses seeking to operate in Australia by providing digital or hybrid advice (including with respect to investing in cryptocurrencies), there are licensing requirements under the Corporations Act. ASIC has released *Regulatory Guide 255: providing digital financial product advice to retail clients*, which details issues that digital advice providers need to

consider generally, during the AFSL application stage and when providing digital financial product advice to retail clients.

Mining

At the time of writing, there are no prohibitions on mining bitcoin or other cryptocurrencies in Australia.

Cryptocurrency mining taxation

The ATO has released some guidance on its approach to taxation in relation to cryptocurrency mining activities. The summary below applies to miners or business owners who are Australian residents for tax purposes.

Income derived by a taxpayer from ‘carrying on a business’ of mining cryptocurrency must be included in the calculation of their assessable income. Whether or not a taxpayer’s activities amount to carrying on a business is “a question of fact and degree”, and is ultimately determined by a weighing up of the taxpayer’s individual facts and circumstances. Generally (but not exclusively), where the activities are undertaken for a profit-making purpose, are repetitious, involve ongoing effort, and include business documentation, the activities would amount to “carrying on a business”.

Cryptocurrency miners would also be subject to tax on any gains or profits derived from transferring cryptocurrency mined to a third party.

Where carrying on a business, outgoing and losses would be deductible to the taxpayer (subject to integrity measures and the ‘non-commercial loss’ rules).

Whether or not GST is payable by a cryptocurrency miner on its supply of new cryptocurrency (e.g., by way of an ICO) depends on a number of factors, including its specific features, whether the miner is registered for GST, and whether the supply is made in the course of the miner’s enterprise.

The specific features of cryptocurrency include it being a type of security or other derivative; it being “digital currency” as defined in the GST legislation (see ‘Taxation’, above); or it providing a right or entitlement to goods or services. If the cryptocurrency is “digital currency”, its supply will not be subject to any GST because it will be an input taxed financial supply (assuming the other requirements are satisfied).

A cryptocurrency miner would generally be required to register for GST if its annual GST turnover is \$75,000 or more, excluding the value of its supplies of digital currencies and other input-taxed supplies. However, a miner who does not satisfy this GST registration threshold may nevertheless elect to register for GST in order to claim from the ATO full or reduced input tax credits (i.e., GST refunds) for the GST cost of its business acquisitions (but acquisitions that relate to the sales or acquisitions of digital currencies are *prima facie* non-creditable or non-refundable).

Cybersecurity

More generally, with the rise of cloud-based bitcoin mining enterprises in Australia, mining businesses should carefully consider cybersecurity issues in relation to mining activities. For example, earlier in 2018, employees at the Bureau of Meteorology were investigated after breaching information technology security systems by allegedly mining cryptocurrency using bureau technology.

In its Corporate Plan 2017–18 to 2020–21, ASIC signalled that cyber resilience would be a key focus area for the regulator, and to date has released regulatory guidance indicating

its expectations for licensees' cloud computing security arrangements. Two reports, namely *429 Cyber resilience: Health check* and *555 Cyber resilience of firms in Australia's financial markets*, examine and provide examples of good practices identified across the financial services industry. The reports contain questions that board members and senior management of financial organisations should ask when considering cyber resilience.

Border restrictions and declaration

There are currently no border restrictions or obligations to declare cryptocurrency holdings when entering or leaving Australia.

The AML/CTF Act mandates that both individuals and businesses must submit reports where physical currency in excess of A\$10,000 (or foreign currency equivalent) is brought into or taken out of Australia. Significantly, this requirement has so far been restricted to 'physical currency', which AUSTRAC has defined as being any coin or printed note of Australia or a foreign country that is designated as legal tender, and is circulated, customarily used and accepted as a medium of exchange in the country of issue. Although recent discourse indicates that some governments have created or are attempting to issue official cryptocurrencies, the intangible nature of cryptocurrency seems to remain a bar to cryptocurrency being captured by declaration obligations under the AML/CTF Act.

It should be noted that the AML/CTF Act was recently amended to address some aspects of cryptocurrency transfer and exchange; however, this amendment did not see the scope of AML/CTF regulation widen the border restrictions. At the time of writing, there appears to be no indication that any such further amendment to include border restrictions is being contemplated.

Reporting requirements

The AML/CTF Act imposes obligations on entities that provide 'designated services', including the provision of DCE services. These obligations include record-keeping and reporting requirements. AUSTRAC has released draft AML/CTF rules, which outline reportable details for matters including but not limited to threshold transaction reports (**TTRs**). TTRs will be required to be submitted where transactions over A\$10,000 have occurred.

Reportable information includes, among other details, the denomination or code of the digital currency and the number of digital currency units, a description of the digital currency including details of the backing asset or thing (if known), the Internet Protocol address information of the payee, the social media identifiers of the payee, and the unique identifiers relating to the digital currency wallet of the payee.

Consultation on the draft AML/CTF rules closed in February 2018. At the time of writing, no further updates have been released.

Estate planning and testamentary succession

To date, there has been no explicit regulation or case law surrounding the treatment of cryptocurrency in Australian succession law. Generally, if estate plans do not cater for cryptocurrency and steps are not taken to ensure executors can access a deceased's cryptocurrency, it may not pass to the beneficiaries.

A will should be drafted to give the executor authority to deal with digital assets. As cryptocurrencies are generally held anonymously, a will should also establish the existence

of the cryptocurrency as an asset to be distributed to beneficiaries. A method must also be established to ensure passwords to digital wallets and external drives storing cryptocurrency are accessible by a trusted representative. Unlike a bank account which can be frozen upon death, anyone can access a digital wallet, so care should be taken to ensure external drives and passwords are not easily accessible on the face of the will. This may include providing a memorandum of passwords and accounts to the executor to be placed in a safe custody facility which remains unopened until a will is called upon.

There may also be tax implications arising for the beneficiaries of cryptocurrencies, which are similar to the tax implications for cryptocurrency holders. See 'Taxation' above, for further details.

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Georgina is a lawyer in Gilbert + Tobin's Corporate Advisory group with a focus on the Australian financial services laws, funds management and anti-money laundering regulation.

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Georgina is involved in a number of innovation initiatives co-ordinated by Gilbert + Tobin. She participated in a legal hackathon, which Gilbert + Tobin hosted in conjunction with Westpac and LegalVision in January 2016 and which won the award for Innovation in use of Technology at the *Financial Times* Innovative Lawyers Awards Asia-Pacific 2016.

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