THE BIG PICTURE:

Blockchain

A mature new phase?

June 2019

Blockchain technology looks set to continue to make its presence felt in the business world this year, although increasingly in a more conventional corporate context.

The sector has somewhat deserved its 'Wild West' reputation but, despite setbacks and volatility, projects are continuing to build in this space and interest from corporate technology teams is growing. As some of the hype associated with the crypto boom dissipates, moves among large corporates and financial sector participants indicate use of blockchain technology is entering a new phase. As use continues to expand, so does the need for regulation. All eyes are on the regulators globally as they show readiness to grapple with the emerging issues. Here are some of the key developments from around the world.

Facebook's coin?

On 18 June, social media platform Facebook unveiled its own digital currency, to be developed and issued by its subsidiary Calibra. Libra is a 'non-volatile' cryptocurrency which will be backed by a basket of various foreign currencies (so its value may be stable but not pegged to a specific currency). The Libra coin is marketed as being "a new global currency on a new global network". The platform is not yet live, but users can sign up for early testing access. Importantly, Calibra actively markets its product as being able to provide financial access to those in countries without easy access to banking facilities. Initially, payment will be facilitated through apps such as Messenger, but direct merchant payments will come later. Calibra has an extensive range of partnerships including payment providers such as Visa and Paypal along with service providers like Uber. Legal issues arising in relation to this platform will include regulatory compliance such as anti-money laundering rules, security laws and taxation. With such advancements come questions around social media platforms 'native coin' including how easy it may be to convert them into other cryptocurrencies such as bitcoin. Tax issues may also arise for participants that are able to earn digital currencies through social media participation or data sharing agreements.

Cryptocurrency tax crackdown

During the crypto-boom there was a sense that somehow normal tax laws didn't apply to dealings in crypto-assets. The Australian Tax office (ATO) doesn't see it that way and is cracking down on cryptocurrency tax obligations, launching a data-matching programme that will enhance their ability to identify those who have not honoured their tax obligations. The programme is an effort "to help taxpayers to get it right and ensure they are paying the correct amount of tax," says Will Day, Deputy Commissioner of the ATO. The programme will collect data records, including purchase and sale information, from cryptocurrency designated service providers. Data provided will be matched against ATO records to identify individuals who may not be meeting their obligations. If New Zealand's IRD follows the ATO's lead and launches its own audit programme, it could do so using tax information sharing agreements to obtain account information from offshore exchanges. If that happens it will be important that investors have complied with their tax obligations. If not, it may be necessary to obtain advice on a possible voluntary disclosure to minimise tax penalties.

Commercial blockchain platforms

Blockchain enterprise solutions are becoming widely recognised by technology teams across the corporate and commercial sector. UK-based multinational financial services company **Legal & General** is set to use blockchain technology to create a system that will manage the insurance company's bulk annuities.

Meanwhile multinational technology company Microsoft has released a new blockchain development kit that will make enterprise blockchain more approachable, including an extension offering an enhanced experience for building blockchain apps.

Cryptopia in liquidation

Digital currency exchange **Cryptopia has gone into liquidation** following a hack early this year, which involved the theft of what some estimate to be over NZ$24 million of their cryptocurrency assets. The highly publicised hack had a "severe impact" on the company's trade, and despite efforts to return to profitability, Cryptopia was put into liquidation. This comes as a warning that as the price of cryptocurrencies rise, so will the attention of hackers. It also raises questions that must be carefully considered around the insolvency aspects of crypto exchanges. The liquidation also put a halt to Cryptopia's plans to launch a New Zealand dollar-backed stable coin. No other similar stable coin has been publicly discussed, although the Reserve Bank of New Zealand has carried out some policy work on a possible Government issued token.

Cashing out? Meanwhile, on 19 June the Reserve Bank of New Zealand released a paper on the **Future of Cash Use**. "We think New Zealand should be making conscious decisions about the future of cash so that we can be prepared for future innovations, and ensure that sectors of society are not unfairly disadvantaged because cash falls out of favour," said Reserve Bank Governor Adrian Orr.

Move over, ICOs

Meanwhile, internationally talk of ICOs (initial coin offerings) to raise funds has subsided since the peak of early 2018, but overall investment in the space has not. Instead, there has been a shift towards "IEOs" – initial exchange offerings. The difference? The digital tokens sold in an IEO are sold through an exchange, meaning that the tokens are ready to trade on an exchange immediately after the IEO is completed. A lot of tokens offered through ICOs never got listed on an exchange, so an IEO takes that risk away for investors. Other attractions potentially include a sense that offerings will be of higher quality, assuming that the exchanges do some filtering of projects. Also they can avoid the duplication of anti-money laundering / know your client checks. According to the Wall Street Journal, which cites digital currency research from New York-based data provider TradeBlock, about US$518 million has been raised through 63 IEOs so far this year, to May. Due to regulatory concerns, participation in IEOs is often limited to investors in certain countries. New Zealand has pretty transparent and friendly regulatory settings for coin offerings, following FMA guidance, but doesn't make the list. For example, IEOs launched by the largest cryptocurrency exchange in the world, Binance, are blocked to New Zealand investors. That may be more to do with having a relatively shallow pool of crypto investors rather than problems with our regulatory settings.

Bitcoin futures and other financial products

Members of the global finance industry are starting to see opportunities to generate financial products centred around crypto-assets. Bitcoin futures have recently been launched by organisations like Chicago Mercantile Exchange. New York stock exchange operator Intercontinental Exchange has also announced plans to launch "physically settled" bitcoin futures product through an exchange BAKKT (with testing of the platform from 22 July 2019) – physical settlement is important as it means that the issuer would need to hold and be able to deliver those bitcoins. Others like Fidelity, Nasaq and Greyscale Trust also appear to be moving into this area and bringing through their own cryptocurrency products. Meanwhile, the US Securities and Exchange Commission is considering a number of proposals to allow trading of bitcoin based exchange traded funds (ETFs) – there have been a number of delays in this process but a final decision is expected later this year. With a number of impending Bitcoin derivatives, expect this sector to be worth watching. New Zealand regulators may be following these developments with interest and we could see similar products available to New Zealand markets depending on how our law develops.

How to tax forks

The US Internal Revenue Service (IRS) is expected to issue guidance on the taxation of virtual currency transactions, after the IRS Commissioner confirmed it was a priority following an enquiry by a US congressman. The IRS last offered cryptocurrency guidance in 2014. The new guidance is expected to address many uncertainties including calculating cost basis, and the tax treatment of separated blockchain, providing investors with 'bonus coins', also known as "forks". The big question is whether New Zealand or other jurisdictions will borrow from these principles in determining their own tax policy.

Securities regulation?

A bill has been introduced in the US that if approved will offer greater clarity around the regulation of cryptocurrencies. The Token Taxonomy Act is designed to be more inclusive of changing technology, offer a clearer definition of digital tokens, and amend current securities law to offer clarity on the enforcement of securities laws surrounding cryptocurrency.

Eyes on the G20

Internationally, leaders of the G20 agreed at the start of the year to focus on addressing how cryptocurrencies will be regulated, which comes as a response to individuals and companies using tax loopholes to their advantage. G20 leaders have said that their work seeks a "consensus-based solution to address the impacts of the digitalization of the economy on the international tax system". Following a G20 meeting held in Japan this month G20 central bank governors and finance ministers also issued a joint communique, requesting risks around crypto assets be monitored. G20 leaders will meet again at the Osaka Summit in Japan at the end of this month. Key issues for regulations include anti-money laundering requirements and taxation.

Contacts

Bell Gully has market-leading expertise in blockchain and other distributed ledger-based applications, including in the financial services sector.

Our experts work to ensure ventures of this type have the best prospect of success. Our skilled team work closely alongside our technology, intellectual property, data, privacy, and corporate and tax specialists, to provide advice and targeted solutions for businesses.

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