GLI GLOBAL LEGAL INSIGHTS

Blockchain & Cryptocurrency Regulation

2021

Third Edition

Contributing Editor: **Josias N. Dewey**

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GLOBAL LEGAL INSIGHTS – BLOCKCHAIN & CRYPTOCURRENCY REGULATION

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PREFACE

Another year has passed and virtual currency and other blockchain-based digital assets continue to attract the attention of policymakers across the globe. A lack of consistency in how policymakers are addressing concerns raised by the technology is a major challenge for legal professionals who practice in this area. Perhaps equally challenging is keeping up with the nearly infinite number of blockchain use cases. In 2017 and 2018, it was the ICO craze. In 2019, the focus shifted to security tokens. In 2020, decentralized finance (or DeFi) attracted over several billion dollars' worth of investment. So, while ICOs are still being offered and several groups continue to pursue serious security token projects, we should expect DeFi to draw scrutiny from regulators, such as the U.S. Securities and Exchange Commission (SEC). Once again, legal practitioners will be left to counsel clients on novel issues of law raised by the application of laws and regulations enacted long before blockchain technology existed.

Of course, capital raising is only one application of the technology. Bitcoin, which remains the king of all cryptocurrencies, was intended to serve as a form of digital money. Arguably, it is this use case that has seen the most attention from governments around the word. The European Union enacted more stringent anti-money laundering (AML) regulations impacting virtual currency exchanges operating in the EU. U.S. regulators and state government officials continue to enforce money transmitter statutes and BSA regulations applicable to money services businesses. In the U.S., the state of New York, which was once thought to have over-regulated the industry out of doing business in the state, is now attracting applications from blockchain companies to become state-chartered trust companies. The charter may provide relief to virtual currency exchanges and similar businesses seeking to avoid the nearly 50-state patchwork of licensing statutes.

Institutional and large enterprise companies continue to expand into the space. It is no longer just FinTechs and entrepreneurial clients who need counsel on blockchain-related matters. Whether a small start-up or Fortune 100 company, clients need counsel in areas beyond compliance with government regulation. In some cases, intellectual property rights must be secured, or open source licenses considered to the extent a client's product incorporates open source code. Blockchain technology adopted by enterprise clients may involve a consortium of prospective network users, which raises joint development issues and governance questions.

As with the first two editions, our hope is that this publication will provide the reader with an overview of the most important issues across many different use cases and how those issues are impacted by laws and regulations in several dozen jurisdictions around the globe. And while policymakers continue to balance their desire to foster innovation, while protecting the public interest, readers of this publication will understand the current state of affairs, whether in the U.S., the EU, or elsewhere in the world. Readers may even discover themes across this book's chapters that provide clues about what we can expect to be the hot topics of tomorrow and beyond.

Josias N. Dewey
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FOREWORD

Dear Industry Colleagues,

On behalf of the Enterprise Ethereum Alliance ("EEA"), I would like to thank Global Legal Group ("GLG") for bringing to life an explication of the state of regulation in the blockchain and cryptocurrency sector, with its third edition publication of *Blockchain & Cryptocurrency Regulation*. GLG has assembled a remarkable group of leaders in the legal industry to analyse and explain the environment in front of us, and the EEA members and participants were pleased to contribute to the publication.

We stand at the beginning of an industry, and the depth and breadth of the contributors from leading law firms across the world only serve to highlight the growing interest and fascination with accelerating the adoption of blockchain technology. We thank each of the authors for taking the time to compose their chapters and for the expertise they demonstrate. We hope readers will find this publication useful.

The EEA is the industry's first member-driven global standards organisation whose mission is to develop open, blockchain specifications that drive harmonisation and interoperability for businesses and consumers worldwide. The EEA's world-class Enterprise Ethereum Client Specification, Off-Chain Trusted Compute Specification, and forthcoming testing and certification programs, along with its work with the Token Taxonomy Initiative, will ensure interoperability, multiple vendors of choice, and lower costs for its members – hundreds of the world's largest enterprises and most innovative startups. For additional information about joining the EEA or the Token Taxonomy Initiative, please reach out to membership@entethalliance.org and info@tokentaxonomy.org.

Sincerely,

Aaron Wright

Chairman, EEA Legal Advisory Working Group

GLOSSARY

***Alice* decision**: a 2014 United States Supreme Court decision about patentable subject matter.

Cold storage: refers to the storage of private keys on an un-networked device or on paper in a secure location.

Copyleft licence: the practice of offering people the right to freely distribute copies and modified versions of a work with the stipulation that the same rights be preserved in derivative works down the line.

Cryptocurrencies: a term used interchangeably with virtual currency, and generally intended to include the following virtual currencies (and others similar to these):

- Bitcoin.
- Bitcoin Cash.
- DASH.
- Dogecoin.
- Ether.
- Ethereum Classic.
- Litecoin.
- Monero.
- NEO.
- Ripple's XRP.
- Zcash.

Cryptography: the practice and study of techniques for secure communication in the presence of third parties, generally involving encryption and cyphers.

DAO Report: report issued in July, 2017 by the U.S. Securities and Exchange Commission, considering and ultimately concluding that The DAO (*see below*) was a security.

Decentralised autonomous organisation ("The DAO"): a failed investor-directed venture capital fund with no conventional management structure or board of directors that was launched with a defect in its code that permitted someone to withdraw a substantial amount of the $130,000,000 in Ether it raised.

Decentralised autonomous organisation ("a DAO"): a form of business organisation relying on a smart contract (*see below*) *in lieu* of a conventional management structure or board of directors.

Digital assets: anything that exists in a binary format and comes with the right to use, and more typically consisting of a data structure intended to describe attributes and rights associated with some entitlement.

Digital collectibles: digital assets that are collected by hobbyists and others for entertainment, and which are often not fungible (e.g., CryptoKitties) (*see* **Tokens**, non-fungible).

Digital currency: a type of currency available only in digital form, which can be fiat currency or virtual currency that acts as a substitute for fiat currency.

Digital currency exchange: a business that allows customers to trade cryptocurrencies or digital currencies for other assets, such as conventional fiat money, or one type of cryptocurrency for another type of cryptocurrency.

Digital/electronic wallet: an electronic device or software that allows an individual to securely store private keys and broadcast transactions across a peer-to-peer network, which can be hosted (e.g., Coinbase) or user managed (e.g., MyEtherWallet).

Distributed ledger technology ("DLT"): often used interchangeably with the term *blockchain*, but while all blockchains are a type of DLT, not all DLTs implement a blockchain style of achieving consensus.

Fintech: new technology and innovation that aims to compete with traditional financial methods in the delivery of financial services.

Initial coin offering: a type of crowdfunding using cryptocurrencies in which a quantity of the crowdfunded cryptocurrency is sold to either investors or consumers, or both, in the form of "tokens".

Initial token offering: *see* **Initial coin offering**.

Internet of Things: a system of interrelated computing devices, mechanical and digital machines, objects, animals or people that are provided with unique identifiers and the ability to transfer data over a network without requiring human-to-human or human-to-computer interaction.

Licences, software: the grant of a right to use otherwise copyrighted code, including, among others:

- Apache.
- GPLv3.
- MIT.

Mining, cryptocurrency: the process by which transactions are verified and added to the public ledger known as the blockchain, which is often the means through which new units of a virtual currency are created (e.g., Bitcoin).

Money transmitter (U.S.): a business entity that provides money transfer services or payment instruments.

Permissioned network: a blockchain in which the network owner(s) decides who can join the network and issue credentials necessary to access the network.

Platform or protocol coins: the native virtual currencies transferable on a blockchain network, which exist as a function of the protocol's code base.

Private key: an alphanumeric cryptographic key that is generated in pairs with a corresponding public key. One can verify possession of a private key that corresponds to its public key counterpart without exposing it. It is not possible, however, to derive the private key from the public key.

Private key storage:

- *Deep cold storage*: a type of cold storage where not only Bitcoins are stored offline, but also the system that holds the Bitcoins is never online or connected to any kind of network.
- *Hardware wallet*: an electronic device capable of running software necessary to store private keys in a secure, encrypted state and structure transactions capable of being broadcast on one or more blockchain networks. Two popular examples are Ledger and Trezor.

Protocols: specific code bases implementing a particular blockchain network, such as:

- Bitcoin.
- R3's Corda.
- Ethereum.
- Hyperledger Fabric.
- Litecoin.

Public network: blockchain that anyone can join by installing client software on a computer with an internet connection. Best known public networks are Bitcoin and Ethereum.

Qualified custodian: a regulated custodian who provides clients with segregated accounts and often places coins or tokens in cold storage (*see above*).

Robo-advice/digital advice: a class of financial adviser that provides financial advice or investment management online, with moderate to minimal human intervention.

Sandbox (regulatory): a programme implemented by a regulatory agency that permits innovative start-ups to engage in certain activities that might otherwise require licensing with one or more governmental agencies.

Security token: a token intended to confer rights typically associated with a security (e.g., stock or bond), and hence, are generally treated as such by regulators.

Smart contract: a piece of code that is written for execution within a blockchain runtime environment. Such programmes are often written to automate certain actions on the network, such as the transfer of virtual currency if certain conditions in the code are met.

Tokens: a data structure capable of being fungible (ERC-20) or non-fungible (ERC-721) that is capable of being controlled by a person to the exclusion of others, which is typically transferable from one person to another on a blockchain network.

Utility token: a token intended to entitle the holder to consume some good or service offered through a decentralised application ("dApp").

Vending machine (Bitcoin): an internet machine that allows a person to exchange Bitcoins and cash. Some Bitcoin ATMs offer bi-directional functionality, enabling both the purchase of Bitcoin as well as the redemption of Bitcoin for cash.

Serbia

Bojan Rajić & Mina Mihaljčić
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in cooperation with Schoenherr

Government attitude and definition

In March 2019, the Securities Commission of Serbia ("Commission") issued a Statement on the regulation of crypto-assets in the Republic of Serbia ("Statement"), under which the Commission, in cooperation with the Office of the Prime Minister, launched a public consultation process on the regulation of crypto-assets in Serbia. Here it should be noted that although the Statement is not considered an official opinion of the Commission, we may look at it as a reflection of its current understanding and position on the matter.

Since there is a lack of clarity as to how the Serbian regulatory framework applies to crypto-assets, such instruments raise specific challenges for regulators and market participants. The Commission's current position is that the development of crypto-assets does not currently raise financial stability issues. Such opinion is in line with the paper issued by the European Securities and Market Authority ("ESMA") in its Advice Paper (*Initial Coins Offerings and Crypto-Assets*), issued on 9 January 2019. Also, the Commission has noted that the IT industry in Serbia is on the rise and in order to support the development of the industry, it is necessary to ensure legal certainty. The Commission believes that this could be achieved by establishing the competent institutions regarding crypto-assets, but also by application of the existing regulations where appropriate. However, there is also a concern about the risks that could affect the Serbian market or prospective investors.

In its Statement, the Commission outlined its position on the gaps and issues that exist in the rules in situations when crypto-assets qualify as financial instruments and the risks that can arise when crypto-assets do not qualify as financial instruments.

The Commission believes that crypto-assets that can be qualified as one of the financial instruments under Article 2(1) of the Capital Markets Act (*RS Official Gazette, nos 31/2011, 112/2015, 108/2016 and 9/2020 (subsequent amendment)*) ("CMA") are regulated by Serbian law and fall within the Commission's remit.

Accordingly, the Commission defines the criteria for determining whether a crypto-asset could be qualified as a financial instrument or not. Taking into account the definition of *transferable securities* as defined in the CMA, a crypto-asset would have the features of a transferable security if it were: (i) not used for purchasing goods and services; (ii) negotiable on the capital market; and (iii) to include at least one of the following: (A) right to a participation in the issuer's capital or voting rights; (B) right to register the rights defined under item (A) with the relevant public register; (C) right to receive remaining assets (liquidation proceedings); (D) right to a claim from the issuer determined as a fixed sum with a maturity of more than 397 days from the day of issue; (E) right to register the rights defined under item (D) with the relevant public register; (F) right to acquire securities;

and/or (G) right to a claim from the issuer determined by reference to transferable securities, currencies, interest rates, incomes, commodities, indices or other measures.

The Commission's preliminary view is that where crypto-assets qualify as financial instruments, the regulatory framework stipulated by the CMA should apply to them and to all transactions with respect to the crypto-assets. In such case, the provisions on prospectuses, reporting and rules on secondary trading must be applied as well. So, IT companies dealing with such crypto-assets must satisfy all provided conditions and obligations required for issuers of financial instruments. This is particularly applicable to so-called "investment tokens", i.e. digital tokens with an investment/speculative purpose, which are considered already regulated financial instruments issued in the new form, through new blockchain technology.

On the other hand, in cases where crypto-assets do not qualify as financial instruments, the Commission took the position that the existing Serbian legislation cannot be applied directly. The legal framework proposed by the Commission for this type of crypto-asset is similar to the system for issuing and trading in financial instruments established by the CMA and European Union directives. Here, the Commission believes that Serbia has an opportunity to adopt a straightforward regulatory framework – which could have a positive impact on the development of the IT sector.

In this regard, the Commission has proposed the following significant features of the prospective legal framework:

- the Commission would license agents providing professional services with respect to crypto-assets, and the issuers of crypto-assets would be required to conclude an agreement with such agent. Also, the agents would provide advice to issuers in relation to their obligations, represent them before the regulatory authority and file the required reports with the regulatory authority, etc. The agents would have an important role in the prevention of money laundering and terrorism financing;
- the issuer should publish a whitepaper at least 10 days before a crypto-asset has been issued. The whitepaper would be signed by management members of an issuer and would contain the prescribed information. These documents should be similar to a prospectus regulated under the CMA regarding securities, only simpler; and
- anyone who intends to provide services in relation to issuing/trading in crypto-assets will be required to hold a licence issued by the Commission. The services include organisation of trading, receipt and execution of orders, custody services, providing investment advice, portfolio management, etc.

The above overview of the prospective legal framework is not exhaustive, but rather highlights some of its key features.

In a separate instance, the Serbian central bank – the National Bank of Serbia ("NBS") – took a position on whether cryptocurrencies can be considered currencies. Namely, on 3 November 2017, NBS issued an official opinion on cryptocurrencies pursuant to which it confirmed that cryptocurrencies are not considered currencies under Serbian law. Accordingly, trading of cryptocurrencies and platforms for internet trading of cryptocurrencies are not subject to NBS supervision. The exceptions to this are matters regarding anti-money laundering regulations, where NBS explicitly recognises its supervising authority (please see "Money transmission laws and anti-money laundering requirements" below).

NBS further emphasised its concern about the risks Bitcoin poses to cryptocurrency users, and also issued a separate warning stating that anyone involved in virtual currency activities is doing so on their own responsibility, bearing their own financial risk.

Cryptocurrency regulation

While Serbian law does not prohibit cryptocurrencies, there is currently no specific legislation applicable to cryptocurrencies either. However, in the last two years, different proposals for governing cryptocurrencies and related matters have been published (please see "Government attitude and definition" above).

Sales regulation

In cases where cryptocurrencies can be qualified as financial instruments (for details, please see "Government attitude and definition" above), the provisions of the CMA must be applied to the sale process. On the other hand, in cases where cryptocurrencies do not qualify as financial instruments, the general civil law rules (particularly the Serbian Obligation Act) would apply.

However, it should be noted that, at this time, cryptocurrencies have not yet been explicitly qualified as securities, nor are they subject to the CMA.

Taxation

Serbia has not enacted any specific tax regulation concerning cryptocurrencies. Accordingly, Serbian tax rules do not include any special tax rules for income, profits or gains arising from transactions involving cryptocurrencies.

So far, the Serbian Ministry of Finance has issued only one opinion on cryptocurrencies, following the opinion of NBS, pursuant to which cryptocurrencies, and in particular Bitcoin, are not considered currencies under Serbian law (referred to under "Government attitude and definition" above).

Following the opinion given by NBS, on 26 November 2017, the Ministry of Finance of the Republic of Serbia issued its opinion no. 413-00-168/2017-04, referring to Article 25(1)1) of the Value-Added Tax Act (*RS Official Gazette, nos 84/2004, 86/2004, 61/2005, 61/2007, 93/12, 108/13, 68/14, 142/14, 83/15, 108/16, 13/17, 30/18, 72/19 and 8/20*), which prescribes a tax exemption without the right to deduct input VAT on transactions concerning legal means of payment (legal tender), which cannot be applied to the trade of Bitcoin, as Bitcoin does not represent a form of legal payment in Serbia. Hence, the sale of cryptocurrencies is not subject to VAT in Serbia.

When considering whether cryptocurrencies are subject to income tax, the situation is not clear-cut. Namely, the Individual Income Tax Act does not specify cryptocurrencies as a revenue source subject to income tax. However, the mentioned Act contains a general provision pursuant to which "other revenues" subject to income tax can be "all other revenues not subject to taxes on the basis of other laws or which are not freed from taxes or free from paying taxes on the basis of the Act". Consequently, it should be considered that income arising from the sale of cryptocurrencies, just as that arising from the sale of other assets, can be considered subject to personal income tax (which would in this case be 20%).

Money transmission laws and anti-money laundering requirements

Although crypto-assets are not regulated in the Serbian legal system, provisions of the Law on Prevention of Money Laundering and Terrorism Financing (*RS Official Gazette, nos 113/2017 and 91/2019*) ("AML Act") already cover crypto-assets to a significant extent; i.e. there are grounds for interpretation of the current rules to be applicable to crypto-assets, as it explicitly recognises the term "virtual currencies".

Also, the Serbian Criminal Code (*RS Official Gazette, nos 85/2005, 88/2005, 107/2005, 72/2009, 111/2009, 121/2012, 104/2013, 108/2014, 94/2016 and 35/2019*) ("Criminal Code") sanctions the crime of money laundering. Namely, under the Criminal Code:

> "*The one who converts or transfers assets while aware that such assets originate from a criminal activity, with intent to conceal or misrepresent the unlawful origin of the assets, or conceals and misrepresents facts on the assets while aware that such assets originate from a criminal activity, or obtains, keeps or uses assets with the intent, at the moment of receiving, that such assets originate from a criminal activity, shall be punished by imprisonment of six months to five years and a fine.*"

The Commission believes that the term "asset" can be interpreted to include crypto-assets, so the Criminal Code regulates laundering of crypto-assets as a criminal activity as described.

Additionally, the AML Act stipulates that NBS supervises legal persons and individuals that provide services in relation to virtual currencies. The most recent update in AML regulations in Serbia was made by the latest amendments to the AML Act (December 2019). These amendments introduced a new set of rules aiming to regulate prevention of money laundering and terrorism financing in more detail, also introducing the term "virtual currency". A virtual currency is defined as a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat (conventional) currency and does not have legal tender status, but is accepted by natural or legal persons as a means of exchange and can be transferred, stored or traded electronically.

Promotion and testing

At the time of writing, we are not aware of any public "sandbox" or other programmes aimed at specifically promoting research or investment into cryptocurrencies in Serbia. However, there are various initiatives in the private sector in Serbia that directly or indirectly promote blockchain technologies.

Ownership and licensing requirements

If cryptocurrencies are used as financial instruments, they will be subject to stock market regulation. At the time of writing, there are no specific licensing requirements imposed on an investment advisor or fund manager holding cryptocurrencies.

Mining

Mining of cryptocurrencies is not subject to regulation in Serbia. It is not prohibited as such; however, there are no rules that regulate under which conditions and how mining activities can be undertaken. It can hence be deduced that mining is currently permitted in Serbia. Also, no authority has yet assumed the mining of cryptocurrencies as falling under its (explicit) supervision.

Publicly available information and media reports suggest that mining activities are indeed undertaken in Serbia, although they do not appear to be widespread.

Border restrictions and declaration

There are currently no border restrictions or obligations to declare cryptocurrency holdings under Serbian law.

Reporting requirements

There are currently no specific reporting requirements aimed at cryptocurrency payments made in excess of a certain value under Serbian law.

However, it should be presumed that general AML rules may also be applicable to cryptocurrency and blockchain transactions, i.e. that certain AML requirements apply irrespective of the transaction being made in cryptocurrencies or via blockchain (e.g. identification and reporting of activities suspected of money laundering or terrorism financing).

Estate planning and testamentary succession

There are no specific rules as to how cryptocurrencies are treated for purposes of estate planning and testamentary succession.

Even though cryptocurrencies are not explicitly subject to civil law in Serbia, cryptocurrencies could be qualified as intangible assets from a Serbian civil law perspective. As such, they do not differ from ordinary assets and can be included in estate planning and testamentary succession.

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Bojan Rajić specialises in corporate/M&A and employment. Bojan advises international clients on their market entry and is a member of the team that provides full-service transactional support in the implementation of their investments. He is a specialist of contracts and investments incentives. He advised on the sale of IT start-up 3Lateral to Epic Games, Smurfit Kappa Group on the acquisition of the largest integrated packaging business in Serbia, and Telenor on the sale of its subsidiary in Serbia. He advised Adient Seating on the establishment of a new plant in Serbia, including in relation to relevant subsidies and negotiations of the corresponding grants agreement. Recently, Bojan acted as legal counsel and provided all M&A, regulatory and general corporate services to Solelos (former GameCredits), an IT company operating various blockchain-based and cryptocurrency projects.

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Mina Mihaljčić has been an associate with the firm since 2017. She specialises in corporate/M&A. She has advised clients in the IT, telecommunications, banking and finance and packaging industries. Most recently she advised on the sale of an innovative technologies developer from Serbia to Epic Games and the leading telecom operator on the acquisition of a major cable television, broadband internet and mobile service provider. Mina acted as legal counsel and provided all M&A, regulatory and general corporate services to Solelos (formerly GameCredits), an IT company operating various blockchain-based and cryptocurrency projects.

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