

THE VIRTUAL
CURRENCY
REGULATION
REVIEW

THIRD EDITION

Editors

Michael S Sackheim and Nathan A Howell

THE LAWREVIEWS

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PREFACE

We are pleased to introduce the third edition of *The Virtual Currency Regulation Review* (the *Review*). The increased acceptance and use of virtual currencies by businesses and the exponential growth of investment opportunities for speculators marked late 2019 and early 2020. In 2019, it was reported that several of the largest global banks were developing a digital cash equivalent of central bank-backed currencies that would be operated via blockchain technology, and that Facebook was developing its own virtual currency pegged to the US dollar – Libra – to be used to make payments by people without bank accounts and for currency conversions. In 2019, the US House of Representatives’ Committee on Financial Services held a hearing on the potential impact of Libra in which one witness testified that Libra posed a fundamental threat to the ability of sovereign nations to maintain distinct monetary policies and respond to currency crises.

The *Review* is a country-by-country analysis of developing regulatory initiatives aimed at fostering innovation, while at the same time protecting the public and mitigating systemic risk concerning trading and transacting in virtual currencies. In February 2020, the International Organizations of Securities Commissions (IOSCO) published a final report titled ‘Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms’. The final report describes issues and risks identified to date that are associated with the trading of cryptoassets on cryptoasset trading platforms (CTPs). In relation to the issues and risks identified, the report describes key considerations and provides related toolkits that are useful for each consideration. The key considerations relate to: (1) access to CTPs; (2) safeguarding participant assets; (3) conflicts of interest; (4) operations of CTPs; (5) market integrity; (6) price discovery; and (7) technology. IOSCO advised that these seven key considerations (and the related toolkits described in the report) represent specific areas that IOSCO believes jurisdictions could consider in the context of the regulation of CTPs.

Fortunes have been made and lost in the trading of virtual currencies since Satoshi Nakamoto published a white paper in 2008 describing what he referred to as a system for peer-to-peer payments, using a public decentralised ledger known as a blockchain and cryptography as a source of trust to verify transactions. That paper, released in the dark days of a growing global financial market crisis, laid the foundations for Bitcoin, which would become operational in early 2009. Satoshi has never been identified, but his white paper represented a watershed moment in the evolution of virtual currency. Bitcoin was an obscure asset in 2009, but it is far from obscure today, and there are now many other virtual currencies and related assets. In 2013, a new type of blockchain that came to be known as Ethereum was proposed. Ethereum’s native virtual currency, Ether, went live in 2015 and opened up a new phase in the evolution of virtual currency. Ethereum provided a broader platform, or protocol, for the development of all sorts of other virtual currencies and related assets.

In 2020, the global outbreak of the novel coronavirus (or covid-19) impacted virtually every person on the planet and had severe and sudden effects on every major economy. At the time of writing, the pandemic is ongoing and, while some locations are pushing past their respective ‘peaks’ of infection, cities that are central to the global financial markets, such as New York City, remain under strict lockdown orders, with many workers in the financial services sector working remotely. It is unclear when these cities will return to a version of ‘normal’. In the midst of all this chaos, there is a natural experiment under way in the cryptocurrency markets. We are perhaps learning what happens when our governments are strained and their competence is questioned. Since mid-March 2020, when the pandemic hit the United States in earnest (it had already been raging in China, Italy, Iran, etc.), the price of Bitcoin has gone up in essentially a straight line – from approximately US\$5,000 to almost US\$10,000 as at mid-May. Now, to be fair, this follows a significant price decline preceding March, but it is at least interesting to observe that the most widely held cryptocurrency is weathering a significant economic storm with apparent ease.

When we first launched the *Review* three years ago, we were optimistic but sceptical about whether virtual currencies would be widely and consistently in commercial use. However, the virtual currency revolution has come a long way and has endured a sufficient number of events that could or should have been fatal for the asset class. Our confidence in the long-term viability of virtual currency has only increased over the previous year. Virtual currencies and the blockchain and other distributed ledger technology on which they are based are groundbreaking, and are being deployed right now in many markets and for many purposes. As lawyers, we must now endeavour to understand what that means for our clients.

Virtual currencies are borderless: they exist on global and interconnected computer systems. They are generally decentralised, meaning that the records relating to a virtual currency and transactions therein may be maintained in a number of separate jurisdictions simultaneously. The borderless nature of this technology was the core inspiration for the *Review*. As practitioners, we cannot afford to focus solely on our own jurisdictional silos. For example, a US banking lawyer advising clients on matters related to virtual currency must not only have a working understanding of US securities and derivatives regulation; he or she must also have a broad view of the regulatory treatment of virtual currency in other major commercial jurisdictions.

Global regulators have taken a range of approaches to responding to virtual currencies. Some regulators have attempted to stamp out the use of virtual currencies out of a fear that virtual currencies such as Bitcoin allow capital to flow freely and without the usual checks that are designed to prevent money laundering and the illicit use of funds. Others have attempted to write specific laws and regulations tailored to virtual currencies. Still others – the United States included – have attempted to apply legacy regulatory structures to virtual currencies. Those regulatory structures attempt what is essentially ‘regulation by analogy’. In some countries, a virtual currency, which is not a fiat currency, may be regulated in the same manner as money; in other countries, virtual currency may be regulated similarly to securities or commodities. We make one general observation at the outset: there is no consistency across jurisdictions in their approach to regulating virtual currencies. Perhaps the efforts of IOSCO will help to change that going forward, but there is currently no widely accepted global regulatory standard. That is what makes a publication such as the *Review* both so interesting and so challenging.

The lack of global standards has led to a great deal of regulatory arbitrage, as virtual currency innovators shop for jurisdictions with optimally calibrated regulatory structures that provide an acceptable amount of legal certainty and virtual currency scofflaws shop for jurisdictions with regulatory structures that provide no meaningful regulation. While some market participants are interested in finding the jurisdiction with the lightest touch (or no touch), most legitimate actors are not attempting to flee from regulation entirely. They appreciate that regulation is necessary to allow virtual currencies to achieve their potential, but they do need regulatory systems with an appropriate balance and a high degree of clarity. The technology underlying virtual currencies is complex enough without adding layers of regulatory complexity into the mix.

It is perhaps ironic that the principal source of strength of virtual currencies – decentralisation – is the same characteristic that the regulators themselves seem to be displaying. There is no central authority over virtual currencies, either within or across jurisdictions, and each regulator takes an approach that seems appropriate to that regulator based on its own narrow view of the markets and legacy regulations. Again, we are hopeful that IOSCO's efforts will help to encourage the emergence of optimal regulatory structures over time. Ultimately, the borderless nature of these markets allows market participants to 'vote with their feet', and they will gravitate towards jurisdictions that achieve the right regulatory balance of encouraging innovation and protecting the public and the financial system. It is much easier to do this in a primarily electronic and computerised business than it would be in a brick-and-mortar business. Computer servers are relatively easy to relocate; factories and workers are less so.

The third edition of the *Review* provides a practical analysis of recent legal and regulatory changes and developments, and of their effects, and looks forward to expected trends in the area of virtual currencies on a country-by-country basis. It is not intended to be an exhaustive guide to the regulation of virtual currencies globally or in any of the included jurisdictions. Instead, for each jurisdiction, the authors have endeavoured to provide a sufficient overview for the reader to understand the current legal and regulatory environment at a high level.

Virtual currency is the broad term that is used in the *Review* to refer to Bitcoin, Ether, Tethers and other stablecoins, cryptocurrencies, altcoins, ERC20 tokens, digital, virtual and crypto assets, and other digital and virtual tokens and coins, including coins issued in initial coin offerings. We recognise that in many instances the term 'virtual currency' will not be appropriate, and other related terms are used throughout as needed. In the law, the words we use matter a great deal, so, where necessary, the authors of each chapter provide clarity around the terminology used in their jurisdiction and the legal meaning given to that terminology.

Based on feedback on the first and second editions of the *Review* from members of the legal community throughout the world, we are confident that attorneys will find the updated third edition to be an excellent resource in their own practices. We are still in the early days of the virtual currency revolution, but it does not appear to be a passing fad. The many lawyers involved in this treatise have endeavoured to provide as much useful information as practicable concerning the global regulation of virtual currencies.

The editors would like to extend special thanks to Ivet Bell (New York) and Dan Applebaum (Chicago), both Sidley Austin LLP associates, for their invaluable assistance in organising and editing the third edition of the *Review*, and particularly the United States chapter. The assembly of this third edition is made all the more remarkable by the fact that

many of the authors and contributors are working from home, with dogs barking in the background and children at their feet. Special thanks go out to all those dogs and children for being as tolerant as possible as we try to conduct the work of busy lawyers and also produce this *Review*.

Michael S Sackheim and Nathan A Howell

Sidley Austin LLP

New York and Chicago

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IRELAND

Maura McLaughlin, Pearse Ryan, Caroline Devlin and Declan McBride¹

I INTRODUCTION TO THE LEGAL AND REGULATORY FRAMEWORK

The Central Bank of Ireland (CBI) is the authority responsible for the regulation of financial services in Ireland. To date, the CBI has not issued specific guidance dealing with the status or the legality or illegality of virtual currencies or blockchain, and neither has any government department or other public authority. They have also remained largely silent on the applicability of existing financial regulation regarding this new and emerging area. However, the CBI has issued a warning on the dangers associated with cryptocurrencies as well as an Alert on Initial Coin Offerings to warn investors about the risk of losing part or all of their invested money (see Section II).

The Department of Finance issued a discussion paper on virtual currencies and blockchain technology in March 2018, stating that it believes that no single state agency has the capabilities to address all the risks and opportunities in these two areas. The Department has also established an interdepartmental working group whose task it is to monitor developments and consider any policy recommendations that will be necessary to manage risks and recognise opportunities.

A notable exception to the lack of clear guidance being issued is the Irish Revenue Commissioners. While there are no specific rules dealing with the taxation of virtual currencies, the Revenue Commissioners published information on the taxation of virtual currency transactions in 2018, which was updated in April 2020 (see Section IX).

II SECURITIES AND INVESTMENT LAWS

There is no specific virtual currency regulation in Ireland, and regulators have yet to indicate the extent to which existing securities regulation will apply to virtual currencies. The CBI is the competent authority for the purposes of securities law in Ireland, including regarding prospectus, transparency, market abuse and markets in financial instruments law. The principal legislation to be aware of in respect of virtual currencies has its roots in European Union law, and includes the Prospectus Directive, the 2014 European Union Markets in Financial Instruments Directive (MiFID II) and the Alternative Investment Fund Managers Directive.

The CBI has not only published its own warnings in relation to initial coin offerings (ICOs) and virtual currencies, but has also contributed to European Securities and Markets Authority (ESMA) warnings to both consumers and firms engaged in ICOs.

¹ Maura McLaughlin and Caroline Devlin are partners, Pearse Ryan is a consultant and Declan McBride is of counsel at Arthur Cox.

In respect of the application of securities laws to virtual currency regulation, we expect that the CBI will focus on the recognised EU concepts of transferable security and financial instruments as defined in MiFID II, and the characteristics that they view as bringing virtual currencies within those definitions. Depending on their structure, virtual currencies could be classified as transferable securities requiring the publication of a prospectus (or availing of an exemption) prior to their being offered to the public. A pure, decentralised cryptocurrency is unlikely to be a transferable security, while a token with characteristics similar to a traditional share or bond may be. It is also possible that true utility tokens intended for exclusive use on a platform or service will not be transferable securities. The definition of transferable security is non-exhaustive, and it is for each issuer and their advisers to determine whether their cryptocurrency or token is a transferable security.

As in many jurisdictions, the regulatory environment in relation to cryptocurrencies and their interaction with securities law is not yet settled, and ESMA acknowledges that, depending on how an ICO is structured, it may fall outside the regulated space entirely.

III BANKING AND MONEY TRANSMISSION

In Ireland, virtual currency is not regarded as either money or fiat currency. Therefore, virtual currency is typically viewed as being outside the scope of many traditional financial regulatory regimes: for example, deposit taking, electronic money or payment systems.

There is a risk that certain ancillary services in connection with a virtual currency could be subject to regulation as a form of money remittance or transmission under the Second Payment Services Directive (PSD2), or, where PSD2 does not apply, under the Irish regulatory regime for money transmission. For example, the operator of a virtual currency platform who settles payments of fiat currency between the buyers and sellers of virtual currency could be viewed as being engaged in the regulated activities of money remittance or transmission. There are a number of exemptions that may be applicable where, for example, the platform operator is acting as a commercial agent or where the platform could be viewed as a securities settlement system. The application of an exemption would depend on the features of the trading platform.

IV ANTI-MONEY LAUNDERING

The application of existing Irish anti-money laundering requirements to virtual currency is unclear due to uncertainty surrounding the regulatory status of virtual currency. Where a virtual currency or any activity relating to it is subject to regulation (e.g., it has the characteristics of a transferable security), Irish anti-money laundering requirements will apply.

The Fifth Anti-Money Laundering Directive (AMLD5) will impose new anti-money laundering requirements on virtual currency exchanges and custodians operating in Europe. At the time of writing, AMLD5 has not yet been transposed in Ireland.

V REGULATION OF EXCHANGES

The operation of a multilateral system that brings together multiple third parties buying and selling financial instruments is a regulated activity under MiFID II that would require an authorisation. There is a risk that a virtual currency exchange could require authorisation under MiFID II where the virtual currencies are financial instruments within the meaning of

MiFID II (see Section II). Depending on their structure, virtual currencies could be classified as transferable securities for the purposes of MiFID II. The risk increases where the virtual currency has features similar to a share or a bond.

VI REGULATION OF MINERS

There are no restrictions in Ireland on the mining of virtual currency. Where a virtual currency is a form of transferable security, mining activity could be viewed as a form of securities settlement system. However, as mining is carried out on a decentralised basis, it does not fit neatly into any existing regime for securities settlement. On that basis, we would view mining as an unregulated activity under Irish law.

VII REGULATION OF ISSUERS AND SPONSORS

There are no specific regulations applicable to virtual currency issuers or sponsors in Ireland. Rather, they are subject to the existing regulatory frameworks governing traditional securities. If an issuer's virtual currency is a transferable security (which must be determined on a case-by-case basis), the issuer must prepare (and have the CBI approve) a prospectus prior to offering the token for sale to the public, assuming that the sale of the virtual currency would not proceed as an exempt offer pursuant to an exemption contained within the Prospectus Directive. The CBI has stated that it has received initial enquiries from certain virtual currency issuers and sponsors to review such a prospectus; however, we are not yet aware of any token issuers who are engaging with the CBI regarding a formal prospectus.

If a virtual currency does not constitute a transferable security, the requirements of the Prospectus Directive will not apply to its issuance, although ordinary contractual principles and civil liability would continue to be relevant for issuers and sponsors.

See also Section II.

VIII CRIMINAL AND CIVIL FRAUD AND ENFORCEMENT

As stated previously, there is no specific regulation in Ireland dealing with cryptocurrencies or blockchain technology generally. While the same is also true of the area of criminal and civil fraud and enforcement, it is important to be aware of existing financial services regulation covering areas into which certain activities relating to cryptocurrencies and blockchain might fall.

There is the possibility that various ancillary services connected with cryptocurrencies could be considered regulated activities under either PSD2 or other Irish money transmission regulations. Irish anti-money laundering legislation will apply in cases where, for example, a cryptocurrency is considered a transferable security (see Section IV). AMLD5 will impose new regulation on cryptocurrency exchanges in Europe, but has yet to be transposed into Irish law.

As stated in Section II, the CBI has issued a warning in relation to ICOs. While virtual currencies have not yet been classified as securities by the CBI, there has also been no conclusive statement to the contrary. In the absence of final clarification, it is important to be aware that any person breaching Irish prospectus law by offering securities to the public without publication of a prospectus (for an offer not subject to an exemption) is liable on

indictment to a maximum fine not exceeding €1 million or imprisonment for five years, or both, as there is the possibility that ICOs can be considered to be such an offering of securities to the public, depending on their structure (see also Sections II and VII).

IX TAX

There are no specific rules for dealings in cryptocurrencies, and the normal basic principles apply. This was confirmed in a publication issued by the Revenue Commissioners, which was updated in April 2020. The taxation of dealings in cryptocurrencies will depend on the nature of the activities. Thus, the receipt of a cryptocurrency (by way of barter) in lieu of cash for goods or services rendered may be treated as an income or capital receipt, and in turn may or may not be trading, all of which depends on the underlying activity that generated the cryptocurrency. This requires a normal review of the facts. While cryptocurrencies themselves can be difficult to value, the value of a cryptocurrency on the date of a transaction is the relevant figure to be considered for tax purposes. The Revenue Commissioners recognise the practical difficulties in valuation given that there is no one exchange: a practical and reasonable approach is needed, and taxpayers are required to keep contemporaneous records, as this information often cannot generally be verified at a later date.

Dealing in cryptocurrencies of themselves will depend on the nature and level of activity of the dealer. Occasional investment in and disposals of cryptocurrencies would likely be treated as a capital receipt, currently taxed under capital gains tax at a rate of 33 per cent. Where there is significant and regular dealing, this could be considered to be trading, which for a company would be taxed at 12.5 per cent, or at the marginal higher rates for individuals. The actual tax position will depend on an analysis of the specifics of each transaction, and would need a case-by-case consideration, as is normal in any activity.

Companies will normally prepare their accounts in euros. Although Irish legislation permits functional currencies other than the euro to be used, cryptocurrencies are not recognised as a functional currency, and therefore cannot be used in the preparation of accounts for tax purposes.

No Irish VAT arises on the transfer of cryptocurrencies. This follows the ruling in the *Hedqvist* European Court of Justice case in 2014, and the Revenue Commissioners have confirmed that this accords with their view. It is worth bearing in mind that where a cryptocurrency is exchanged for goods and services, while there is no VAT on the supply of that cryptocurrency, the goods or services given in exchange may themselves attract VAT in the normal way. Mining activities (in the cryptocurrency context) are also considered to be outside the scope of VAT on the basis that they are not considered to be economic activities for VAT purposes.

Irish stamp duty should not arise generally on a transfer of cryptocurrencies, although as stamp duty is a tax on documents, the manner in which the transfer takes place would be worth monitoring to ensure that a stampable document has not been created.

The territoriality aspect of cryptocurrencies is still an evolving area. Irish resident (and for individuals, ordinarily resident) persons will usually be liable to tax in Ireland on their worldwide income and gains (subject to any reliefs or exemptions, including double tax treaty reliefs). A non-resident person will generally only be subject to tax on Irish-sourced income or gains, or profits from an Irish trade. In the case of individuals, tax may also apply where

amounts are remitted into Ireland. It is evident, therefore, that understanding the source or situs of cryptocurrencies is of significance in international dealings. This is likely to be an area that will be developed further.

Applying general principles and no special rules to cryptocurrencies allows taxpayers to conduct their activities with a level of certainty, and the Revenue Commissioners guidance is a welcome development.

X OTHER ISSUES

Given the importance of the investment funds industry to Ireland as a destination for international financial services, the implications for the virtual currencies sector need to be considered.

Investment managers are not generally restricted from owning and investing cryptocurrencies, and the licensing requirements do not differ from the usual requirements in this area. Nonetheless, it needs to be borne in mind that the CBI has yet to state its position on the classification of cryptocurrencies, which will potentially change the situation.

XI LOOKING AHEAD

Virtual currencies, and blockchain technology generally, are important areas of innovation and part of a growing technology ecosystem in Ireland. Their importance is exemplified in the setting up of Blockchain Ireland,² a group dedicated to promoting and providing information on DLT and blockchain in Ireland that is chaired by the Industrial Development Authority and with broad public and private sector membership, and also by the CBI announcement that it is in the process of establishing a fintech and innovation hub to enable companies to engage directly with the CBI.

It can therefore be expected that the CBI and government departments and public authorities will issue more guidance on the application of existing regulations to, and classification of, these new and emerging technologies in the short to medium term.

The transposition of the AMLD5 will also have an important impact on the way cryptocurrency exchanges are regulated in Ireland.

2 <https://www.blockchainireland.net/>.

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