Treasury Initial Coin Offerings Issues Paper
HopgoodGanim Lawyers Submission

28 February 2019

1 Definitions and Token Categories	
1.1 What is the clearest way to define ICOs and different categories of tokens?	HopgoodGanim Lawyers is in favour of using the token categories previously published by FINMA. The FINMA categories establish that tokens may be classified as: (a) Payment tokens, which are not financial products but are subject to anti money laundering regulation; (b) Utility tokens, which are tokens that provide digital access to an application or service; or (c) Asset tokens, which may represent participations in physical entities, companies or entitlements to dividends or interest payments. We recognise that defining and placing digital tokens into a predefined category can be difficult as many tokens currently in existence may be a hybrid of the characteristics above. In that situation then it would be appropriate to regulate hybrid tokens in the same way FINMA does. We are also in favour of using the token categories set out by the Monetary Authority of Singapore ("MAS") in their most recent Guide to Digital Token Offerings published 30 November 2018 as we are of the view that these guidelines offer constructive advice to proposed issuers. In particular we see value in the way the MAS Guide sets out specific case studies addressing situations which arise in the course of advising clients. We also agree with the KYC/AML policies set out in the MAS Guide.
2 Drivers of the ICO Market	
2.1 What is the effect and importance of secondary trading in the ICO market?	Secondary trading is very important but not essential to all Blockchain or crypto projects. Utility tokens and payment tokens should be able to be freely trading between parties on secondary markets within restriction or regulation subject only to the protections granted by the Australian Consumer Law. The main issue to address is trading in digital securities or asset backed tokens. The benefits of secondary market trading for ICOs largely mirror those which exist for secondary market trading of traditional securities. These include availability of investment opportunities, ease of comparison and research, and possibility of increasing competition between providers of digital assets. The availability of secondary markets may also arguably be an important part of 'normalising' trading of digital assets. It should also be noted that in the event a new regulatory framework is implemented and some types of digital assets are characterised as securities, it would be reasonable to hold an expectation that secondary trading of digital securities would be legal just as secondary trading of traditional securities is within the current frameworks. There should be no difference between a digital security and a traditional security. A digital security merely utilises a Blockchain as its share registry and this should be acknowledged as being acceptable and appropriate. In Australia it is difficult and expensive to operate a market for securities (such as the ASX) due to the requirement to hold a Markets Licence. At present ASX is not open to listing digital securities or companies that deal in digital securities and this is hampering the development of this nascent space.
2.2 What will be the key drivers of the ICO market going forward?	Over recent years businesses have been using ICOs as an opportunity to quickly raise funds, and some aspects of the market have embraced the chance to purchase digital tokens. Given that a lot of the discussion around ICOs has been speculative, whether the ICO market develops or not will largely depend on regulatory attitudes and whether there is strong, enforceable legislation behind ICOs. So far, the regulatory bodies have primarily treated ICOs cautiously and have failed to take a supportive position in the development of this market. The ASX have taken a further step and publicly stated that ICOs and digital assets are a "scourge". We do not agree with ASX's position, but believe that the creation and development of

	appropriate regulation specific to ICOs will: (a) discourage behaviour which has lead to the 'wild west' notoriety around ICOs and digital asset providers; (b) encourage compliant behaviour and educate ICO providers as to their legal obligations; (c) encourage reputable bodies and established organisations to hold their own ICOs; and (d) encourage members of the community to participate in ICOs. Accordingly, the key driver of the ICO market going forward will be whether there exists regulation specific to the conduct of ICOs and the products they offer, and regulators' attitudes to ICOs. Taking a strong opposition stance to ICOs will not assist in the development of a compliant ICO market and will likely lead to many innovative companies moving offshore, entrench the status quo and cause harm to Australia's economy.
3 Opportunities and Risks	
3.1 How can ICO's contribute to innovation that is socially and economically valuable?	As discussed below, ICOs offer start-up entities faster, easier access to capital. Many start-up entities which look to host ICOs are developing projects which feature blockchain or distributed ledger technology (**DLT**). It is also worth noting that there are various examples of social impact start ups which are using crypto assets as part of projects which have socially valuable objectives. We have acted for donation platforms, citizen science blockchain companies and recycling projects and have assisted them conduct ICOs and build their business. Each of these have been socially responsible projects. Access to capital supports these start ups in developing their projects and testing the potential uses of blockchain and DLT. Fundraising through ICOs also helps to close a potential gap left by traditionally risk-averse investors who find innovative projects using DLT unattractive.
3.2 What do ICO's offer that existing funding mechanisms do not?	Distinct from existing funding mechanisms, ICOs offer start up businesses: (a) the ability to go straight to market without having to go through or access an intermediary first. (b) lower barriers of accessing capital; (c) a means of fundraising at a relatively low cost; and (d) greater spread - start up entities may access funding from investors who may not ordinarily invest as an "angel investor". ICOs also offer investors: (a) the opportunity to invest in innovative start up projects; (b) greater variety of projects or businesses to invest in; and (c) depending on the way the entity is run, and chance to be part of the project's development. Existing crowd funding regulation has unfortunately not gone far enough in providing retail investor the opportunity to invest in early stage companies. This can be seen by the lack of transactions consummated by using the new crowd funding laws and the feedback that we have received from prospective users of these laws are that they are still too regulation heavy and expensive both in time and cost. We strongly urge Treasury and other interested parties to consider the United States JOBS Act as a more appropriate piece of legislation.
3.3 Are there other opportunities for consumers, industry or the economy that ICOs offer?	Yes. We understand that numerous other (non-legal) groups will make comment on this question. Any new industry and method of raising capital will create new opportunities for the wider economy.
3.4 How important are ICOs to Australia's capability to being a global leader in FinTech?	ICOs are an important grassroots means of supporting and facilitating innovation and the development of innovative technologies, particularly in the use of DLT. ICOs are very important for the development of fintech capability. Whether ICO regulation in Australia is supportive or inhibitive to raising funds using digital assets is an important factor in determining whether Australia will increase its fintech capability and whether Australian cities can become fintech hubs in the future. Regulation is an obvious way for fintech start-ups to vote with their feet and move jurisdictions if they are of the view that running their projects from another jurisdiction would be easier or would gain more support.

3.5 Are there other risks associated with ICOs that policymakers and regulators should be aware of?	HopgoodGanim Lawyers has no further comment regarding risks not mentioned in the Issues Paper. HopgoodGanim Lawyers agrees that consumers need to have a proper means of recourse in the event that things go awry. The fact ICOs may be hosted from beyond Australia and impact Australian consumers only adds weight to the argument that appropriate regulation is needed in this area. We note that ASIC has several guides for foreign financial services providers and that it may be useful to have similar guides or regulation for foreign ICO providers.
4 Regulatory Frameworks in Australia	
4.1 Is there ICO activity that may be outside the current regulatory framework for financial products and services that should be brought inside?	HopgoodGanim Lawyers considers that there is no ICO activity that is outside the current regulatory framework that should be brought within it. However, there should be regulatory material addressing features specific to ICOs and digital assets which state that these particular features are outside the regulatory framework. For example, in the case of crypto mining and node rewards systems, there is the possibility for 'returns' but those features are quite distinct from returns generated from financial products such as interests in a managed property trust. Regulators should also note that there may be ICO activity that offers tokens that are not properly characterised as 'shares' or 'units in a managed investment scheme'. ICOs which sell discounted utility tokens or access tokens as a means of fundraising should also remain outside the regulatory framework for financial products and services. Though such tokens form part of the discussion around digital assets and fintech, they are not themselves financial in nature.
4.2 Do current regulatory frameworks enable ICOs and the creation of a legitimate ICO market? If not, why and how could the regulatory framework be changed to support the ICO market?	The currently regulatory framework only goes part way to enabling and supporting ICOs and the creation of a respected ICO market. This is due to uncertainty around classifying tokens as securities or other assets. This uncertainty may be partly due to the "hybrid" nature of digital assets (which may have features associated with traditional securities such as dividends) and "digital asset" traits (such as access to a digital platform). Application of the current regulatory framework to ICOs has also not been assisted by the conservative and cautionary approach taken by regulators when commenting on ICOs and tokens. An unwillingness to definitively answer questions regarding the regulation of ICOs and tokens has in the past been met with frustration from those seeking to conduct an ICO. While the current approach to regulate digital assets using the existing regulatory framework is understandable, it is not sufficient. It fails to recognise or accommodate for the fact that though digital assets may sometimes share features in common with securities, or that platforms may sometimes have features which are in common with traditional financial services, they are inherently different and must be treated differently under the law. Regulation needs to address the characterisation of tokens, and the potential services offered by digital asset platforms or (D)apps. Regulation also needs to recognise that ICOs are a form of fundraising which are distinct from those provided for under the Corporations Act, and there are varying sub-categories of ICOs, some of which may offer returns on investment or the opportunity to buy in equity in the Company. Regulation also needs to address potential secondary trading of tokens offered through ICOs, and note the fact that not all tokens capable of being traded on the secondary market are financial products.
4.3 What, if any, adjustments to the existing regulatory frameworks would better address the risks posed by ICOs?	Adjustments to the existing framework will not be enough to address the issues and concerns around the ICO market.
4.4 What role could a code of conduct play in building confidence in the ICO industry? Should any such code of conduct be subject to regulator approval?	A code of conduct operating alongside bespoke regulation for the conduct of ICOs would be well utilised by the industry and would be welcome in the present climate. Having that code subject to regulator approval would be encouraging also. However, a code of conduct alone would not be enough for the industry and would not give consumers a path for recourse in the event that they seek some avenue for legal action.
4.5 Are there other measures that could be taken to promote a well-functioning ICO market in Australia?	Continuing to communicate clearly with the industry and market about what is expected in the conduct of ICOs will be helpful and encourage appropriate behaviour by market actors. Beyond this, some action by government bodies which indicate a willingness to embrace the potential opportunities offered by DLT, ICOs and crypto assets will help bring ICOs out of its 'wild west' notoriety and into the mainstream.
5 Tax Treatment of ICOs	
5.1 Does the current tax treatment pose any impediments for issuers in undertaking capital raising activities	At present some ICO raises will be deemed to be upfront product sales such that capital raised is reflected on the revenue account of the issuer. We do not regard this as appropriate in most circumstances.

through ICOs? If so, how?	In those circumstances where capital raised is reflected on the revenue account then the issuer should be able to deduct expenses incurred in developing the project in subsequent years and claim as a tax credit (or similar). In our experience the above issue has caused a number of proposed issuers to not proceed with an ICO in Australia, including some which have gone offshore. HopgoodGanim Lawyers has no further comment regarding whether the current tax treatment poses any impediments for issuers undertaking capital raising activities. Given that the tax treatment of the tokens flow from the underlying nature of the rights and obligations attached to the instrument, HopgoodGanim Lawyers agrees with the possible tax outcomes that could arise for the issuer. Where the issuer of the tokens makes regular transactions in tokens, HopgoodGanim Lawyers is of the view that further details/ examples are required to understand how the ICO proceeds could be taxed.
5.2 Is the tax treatment of tokens appropriate for token holders?	HopgoodGanim Lawyers is of the view that the tax treatment for token holders is not appropriate in the event of a chain split.
5.3 Is there a need for changes to be made to the current tax treatment? If yes, what is the justification for these changes?	HopgoodGanim Lawyers is of the view that further consideration should be given to the tax treatment of chain splits. A chain split can be likened to a share split. In the scenario of a share split, section 112-25(3) of the *Income Tax Assessment Act 1997* (Cth) provides that the cost base of the new share is determined by working out each element of the cost base and reduced cost base of the original share at the time of the split, then apportioning, in a reasonable way, each element to each new share. The result is each corresponding element of the new share's cost base and reduced cost base. Accordingly, where there is a chain split, the capital gain derived by the token holder upon disposal of the new cryptocurrency will be higher, as there is no corresponding cost base value to offset against the proceeds.