

## Initial Coin Offering (ICO): submission to Treasury

By: Taylor Tran (taylor@innovationmelbourne.com.au)

28<sup>th</sup> February 2018

Taylor Tran is a strategist with over 20 years professional experience with over 16 years in corporate and 4 years working with start-ups, including blockchain start-ups. Taylor has been involved in a major blockchain hub in Melbourne since 2016 and has seen dozens of ICOs progress through the hub. Taylor has travelled to Singapore and Europe and has seen ICOs in those areas.

Taylor also convenes a number of blockchain events include a crypto / token-based convention in Australia. Taylor has been a university lecturer in business, is a not-for-profit director and holds a degree in accounting and an MBA. Taylor is a member of the Australian Institute of Company Directors and also an associate member of CPA Australia.

### Definitions and Token Categories

#### 1.1. What is the clearest way to define ICOs and different categories of tokens?

At this stage of development in blockchain technology there should only be one definition of a token. This would be along the lines of a digital utility on a future platform (with the token having no immediate value).

The reason why the token has no value (even though it may have been purchased using fiat or cryptocurrencies) is because it is currently not possible to have a regulated contract between the seller and buyer of the token (i.e., the parties can be from any part of the world). Taxation of the purchase may be possible in Australia.

Therefore, the buyer of tokens should (at a minimum) be advised that the token is a purely speculative purchase and holds no immediate real-world value. In Australia, a minimum requirement should be that a token can only be issued by an incorporated company operating under ASIC and that it would be illegal to issue tokens without incorporation. Regulators in Australia should issue a general notice that there is no legal recourse for tokens.

In addition, regulators should monitor and track (as much as possible) 'token' projects advertised in Australia for 'misleading and deceptive conduct' per current Australian laws. The test for such tracking would be that if a project is found to be suggesting that a token has (current or future) value then the project would be fined for misleading and deceptive conduct. This does not stop projects issuing tokens from overseas, however at least the position is made clear in Australia and the general public in Australia are warned about the speculative nature of 'tokens'.

## Drivers of the ICO Market

### 2.1. What is the effect and importance of secondary trading in the ICO market?

Currently, the trading of 'tokens' on various exchanges around the world cannot be regulated unless globally there is an agreed global approach as to how blockchains, DLT, coding, protocols, mining and data centres are to be regulated. This is at least a few years away.

Whilst purest believers in blockchain technology may be of the view that government and regulators have no role in this technology, this is not the basis on which this response is written.

Secondary trading of tokens does in effect give tokens perceived value (if the token is able to be listed on exchanges). However, it is currently not possible to regulate activities on exchanges other than monitoring through current KYC / AML laws.

Overtime, the industry should strive towards achieving uniform laws on how exchanges are to operate. A key rule would be to only allow tokens to be listed once the tokens have received appropriate certifications (through technical audits) by an industry body equivalent to the CPA (but in a technical field). However, this will not be achieved within the next few years so we can only operate under the current environment as we know it.

In the long term the industry should move to a model of regulating blockchains, DLT, coding, protocols, mining and data centres, as well as the certification of tokens. Until that is achieved it is very difficult to attempt to regulate secondary trading.

### 2.2. What will be the key drivers of the ICO market going forward?

Blockchain and DLT will not go away and there will continue to be entrepreneurs who truly believe in the power they can bring to solving some of the world's greatest challenges. We will continue to see new attempts at projects raising funds through tokens and that should be encouraged as long as the buyers of the tokens clearly understand that their purchase of such tokens should be seen as 'donations' with no expectation of return. Should investors want to take part in the project and gain the benefits of potential upsides of the project, those investors should simply buy shares in the business via traditional mechanisms.

The existence of secondary market as it currently stands, however, does provide bad actors an avenue to construct 'pump and dump' scenarios. Likewise, the information asymmetry between project sellers and the general public will continue to leave the general public exposed to scams. Until we have regulated blockchains, DLT, coding, protocols, mining and data centres, as well as the certification of tokens, we cannot effectively regulate exchanges and secondary trading beyond the current approach of prosecuting notable projects on a case-by-case basis.

## Opportunities and Risks

### 3.1. How can ICOs contribute to innovation that is socially and economically valuable?

Using the above suggested approach, we should see a continuation of new start-ups raising through tokens. However, moving forward, the “mum and dad” investors should be protected through the addition of:

- A clear definition of tokens, i.e. a digital token on a future platform (with no immediate value).
- A ‘general warning’ of 100% loss of purchase.
- Some security if the project is in Australia through the formation of a company and applicable laws.

This would allow compelling projects to continue to raise funds through people who are happy to lose money (i.e. the informed buyer) in highly speculative ventures, without significantly increasing the regulatory burden. These ‘informed buyers’ already exist in the market in the form of ‘start-up investors’ who are wide-eyed to the prospect of losing an acceptable amount of money (either through token purchase or the purchase of company shares) on a large number of ventures with the hope that one would become a ‘unicorn’. Another ‘informed buyer’ would come in the form of goodwill people who are happy to put forward small amounts (for a good cause) in support of the project without expecting any return.

### **3.2. What do ICOs offer that existing funding mechanisms do not?**

ICOs allows projects to easily receive funds from the cryptocurrency market or to raise ‘donation’ style funds from ‘informed buyers’. These fundraisers can be free from significant commissions from middlemen platforms (like in the case of Kickstarter) and (if the above is implemented) can also be relatively free from significant regulation. This therefore allows greater freedom and innovation by the start-up community.

### **3.3. Are there other opportunities for consumers, industry or the economy that ICOs offer?**

If the project is genuine, the process of running an ICO provides opportunities for teams to develop significant skills in blockchain technology, marketing, fund raising and community building (just to name a few). These projects (if successful) would go on to contribute significant value to consumers, industry and the economy.

### **3.4. How important are ICOs to Australia’s capability to become a global leader in FinTech?**

If we consider the above as a regulatory sandbox it would encourage more entrepreneurs to ‘play’ with this technology and increase the chances of Australia becoming a global leader in Fintech. Being a global leader in Fintech in Australia is very important; we have one of the world’s most robust banking systems and we need to continue to diversify away from traditional industries such as mining.

### **3.5. Are there other risks associated with ICOs that policymakers and regulators should be aware of?**

The world has already recently experienced a key risk with ICOs in that a large number of projects have raised a significant amount of money and have not and will not deliver any product or service. Investors, particularly some vulnerable “mum and dad” investors may have over invested their life savings through these projects. Although the loss of money through investments in risky start-ups should not be unexpected. The availability of the cryptocurrency and exchange market (acting as a secondary market for tokens and ICOs) provided a liquid and accessible (yet artificial) proxy for value (perceived).

The world should appreciate the fact that blockchain technology is still nascent and matters such as governance, scalability and privacy are still to be resolved. The regulation of the hardware (e.g. data

centres and security of equipment) and software (e.g. exchanges, soft wallets) are still at early stages and are subject to hacking. There are also significant disagreements in the development community about how to solve some of these large issues (e.g. Bitcoin Cash and Ethereum) leading to hard forks and the proliferation of blockchains, coins, tokens and new approaches. This leads to significant misinformation and confusion. Added to this includes the ever-growing number of private and enterprise blockchain and DTL projects.

The process of a technology becoming more mature and widely adopted will be constrained by certain physical limitations such as people (who can code and audit the technology), cost versus benefit (i.e., investments in a new approach when a current approach is adequate) and global consensus on regulation (i.e., regulation of blockchains, DLT, coding, protocols, mining and data centres and the certification of tokens, whether done privately or through government is inadequate at this stage).

These limitations can only be tackled over time, through intervention or natural selection. Until that time the general public should be continuously reminded of the risk and limitations of blockchains and DLT and overall should understand that they stand to lose all moneys invested in such ventures.

## 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?**

If regulation of blockchains, DLT, coding, protocols, mining and data centres and tokens are effective, then these regulations should be separate to the current regulatory framework for financial products.

As tokens currently do not have these regulations in place, it would not pass basic standards and tests for it to be presented as a financial product. For example, basis tests might include the fact that the product passes technical and security specifications or that the product should be sold by a certified vendor. None of this currently exists and therefore it should not fall within the current regulatory framework for financial products.

### **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?**

No. For some of the reasons mentioned in 4.1 and the suggested regulatory areas in 1.1. and 2.1 and throughout. Until regulation is effective at the base layer of the technology, e.g. blockchains, DLT, coding, protocols, tokens and mining and data centres, ICOs cannot be effectively regulated.

### **4.3. What, if any, adjustments to the existing regulatory frameworks would better address the risks posed by ICOs?**

As mentioned in 1.1, 2.1, 4.1 and throughout

### **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?**

The suggestions in 1.1, 2.1, 4.1 could start as stated industry code of conduct and for the industry to be self-regulating. Over time, if a self-regulating code of conduct proves not effective then all areas should be regulated.

**4.5. Are there other measures that could be taken to promote a well-functioning ICO market in Australia?**

Yes. By proactively communicating the risks and approaches mentioned in 3.1, 1.1. and 2.1 and to proactively work with industry (like this consultation paper) to establish industry wide-standards and a code of conduct, whilst progressively introducing regulation (as suggested) over time.

## Tax Treatment of ICOs

**5.1. Does the current tax treatment pose any impediments for issuers in undertaking capital raising activities through ICOs? If so, how?**

No. Tax should occur through normal processes of a 'company' (as suggested above) receiving funds and paying for products and services; whether that be in fiat or cryptocurrencies. There is the argument that taxation should be lowered overall to increase Australia's competitiveness in the start-up industry, however that is not the purpose of this consultation.

**5.2. Is the tax treatment of tokens appropriate for token holders?**

As tokens are a utility and deemed worthless, it should not be taxed until it is transacted. At the point of transaction, the value of the token is the fiat or cryptocurrency price and GST could be taxed on that figure. After the point of purchase capital gains tax could apply if the token is traded out of the platform for which it was intended to be used.

**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?**

No changes are required. Until this whole ecosystem is mature there is no need to change and put the cart before the horse.