



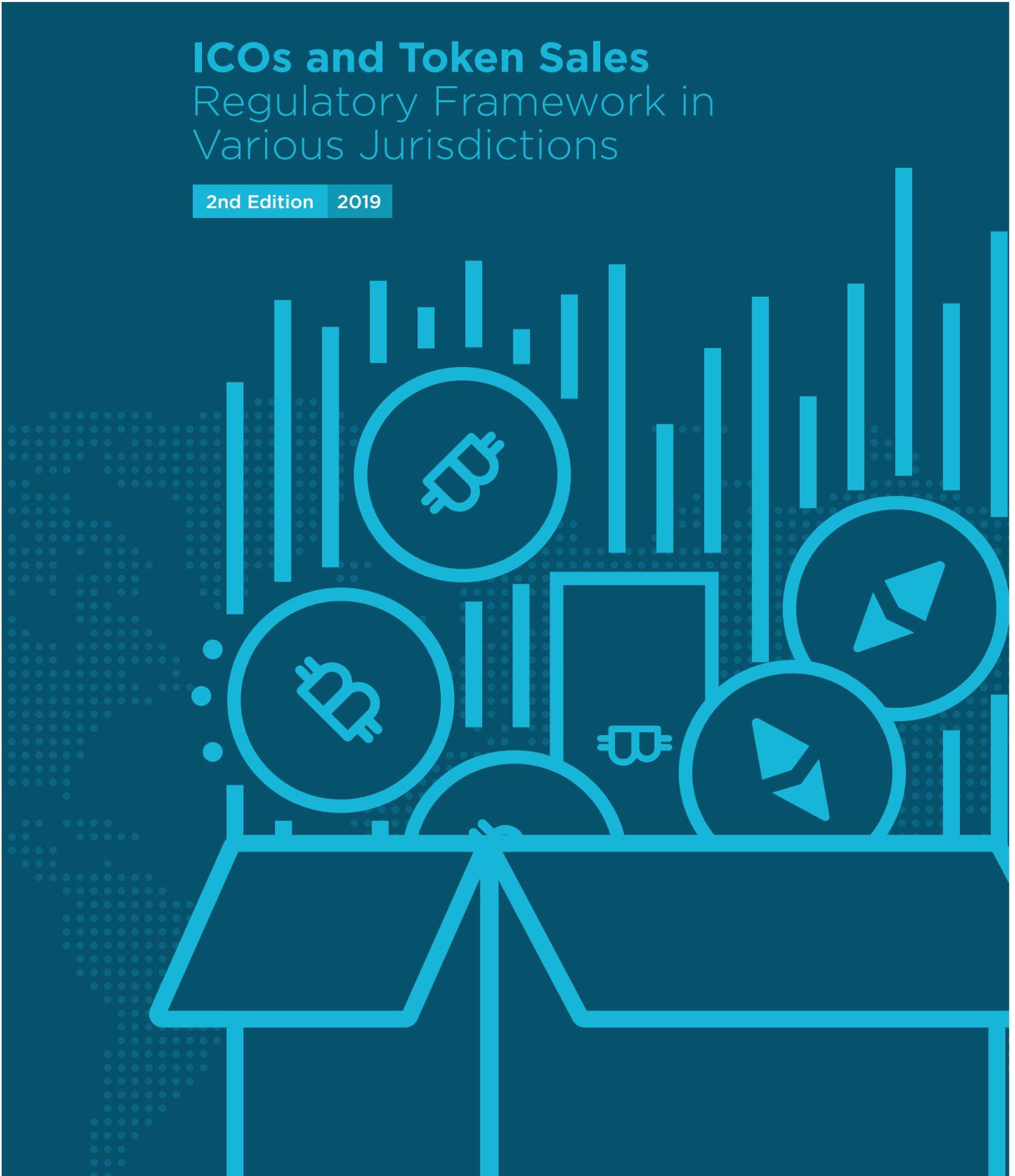
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INTERNATIONAL BUT PERSONAL

ICOs and Token Sales

Regulatory Framework in Various Jurisdictions

2nd Edition 2019



INDEX

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Switzerland [Bratschi Ltd.](#)

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Ukraine [Asters Law](#)

United Kingdom [Mishcon de Reya](#)

United States of America
[Bell Nunnally](#)

Uruguay [Hughes & Hughes](#)

Vietnam [Indochina Legal](#)

THE **13** QUESTIONS WE ASKED

- 1 Does your country allow or prohibit ICOs and Token Sales?
- 2 Does your country regulate ICOs and Token Sales?
- 3 If your country regulates ICOs and Token Sales, what are the names of the government agencies responsible for regulating them?
- 4 If your country regulates ICOs and Token Sales, please provide a short summary of the regulatory framework. For example, do ICOs and Token Sales need to be registered or comply with any rules; or can they only be sold to certain types of purchasers/investors.
- 5 Please provide any additional information you feel is important to understanding ICO and Token Sale regulation in your country.
- 6 If a foreign entity conducts an ICO and offers tokens to residents of your country, will your government require the foreign entity to comply with any rules and regulations? If so, please provide an overview of how ICOs conducted by foreign entities are regulated by the government of your jurisdiction.
- 7 What is the legal nature of crypto in your country (for example, is crypto considered a security, commodity, currency etc.)?
- 8 Has the government of your country prosecuted, civilly or criminally, any ICO issuers, token developers or crypto exchanges for violating your country's laws? If so, please provide an executive summary of the most significant prosecution(s).
- 9 In your country, are there any significant commercial disputes or civil cases (non- government) involving crypto? If so, please provide an executive summary of the most significant dispute(s)/ case(s).
- 10 Does your jurisdiction tax crypto transactions? If so, please provide a basic explanation of how and at what rate they are taxed.
- 11 Separate from ICOs, does your jurisdiction regulate crypto trading or crypto exchanges? If so, please provide an overview of the regulation.
- 12 Does your country offer any unique or important benefit to crypto-focused companies (for example, clear regulatory guidance)? If so, please describe the unique/ important benefit.
- 13 Please identify a point of contact at your firm for cryptocurrency- related matters.

GERMANY

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1 Does your country allow or prohibit ICOs and Token Sales?

German law does not prohibit issuing, selling, purchasing or any other form of trading in cryptocurrencies.

2 Does your country regulate ICOs and Token Sales?

Although over the last few years ICOs and token sales have gained substantial importance in Germany for companies and investors, currently no legislation exists that specifically deals with the initial public offering of cryptocurrencies. In particular, the laws regulating the initial public offerings of shares by stock corporations do not apply to ICOs, irrespective of the similarity of the general terms and the fact that generated tokens are sold in a public bidding process (token sale).

However, even if no specific legislation exists for ICOs in Germany, ICOs or the tokens underlying the ICOs may very well be covered by existing regulations pertaining to the financial sector (see question 4 below for details). The German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)) examines on a case-by-case basis whether specific ICOs or tokens are regulated by such rules and, if it determines this to be the case, it has the authority to prohibit the planned ICOs. Also, non-compliance with such regulations constitutes an administrative offence or misdemeanour.

3 If your country regulates ICOs and Token Sales, what are the names of the government agencies responsible for regulating them?

Notwithstanding the fact that ICOs and token sales have not yet been regulated by specific legislation, this does not mean that they occur in a completely unregulated legal environment. German government authorities monitor the developments of the market for cryptocurrencies very carefully. The primary government agency responsible for monitoring ICOs and token sales in Germany is BaFin.

In addition, the German Central Bank (Deutsche

GERMANY

RITTERSHAUS RECHTSANWALTE

4 If your country regulates ICOs and Token Sales, please provide a short summary of the regulatory framework. For example, do ICOs and Token Sales need to be registered or comply with any rules; or can they only be sold to certain types of purchasers/investors.

Bundesbank) has responsibility for macro-prudential supervision and monetary policy within the scope of the euro system led by the European Central Bank and frequently publishes opinions regarding cryptocurrencies.

Despite the fact that there is no specific legislation governing ICOs and token sales, the offering of cryptocurrencies may be subject to a prospectus requirement according to the German Investment Products Act or the German Securities Trading Act. Depending on the type of token and the ICO process, a banking licence or the approval of the sales prospectus may be required.

BaFin has stated that in the absence of specific legislation it will determine the rules applicable to the specific ICO or token sale on a case-by-case basis, according to the contractual terms of each ICO. BaFin issued an official statement explaining its approach:

‘BaFin determines on a case-by-case basis whether a token constitutes a financial instrument within the meaning of the German Securities Trading Act (Wertpapierhandelsgesetz - WpHG) or the Markets in Financial Instruments Directive (MiFID II), a security within the meaning of the German Securities Prospectus Act (Wertpapierprospektgesetz - WpPG), or a capital investment within the meaning of the German Capital Investment Act (Vermögensanlagengesetz - VermAnlG). BaFin bases its assessment on the criteria set out in the statutory provisions under securities supervision law, i.e. in particular the WpHG, WpPG, Market Abuse Regulation (MAR), VermAnlG as well as other relevant laws and applicable national and EU legal acts in the field of securities supervision.

Market participants providing services related to

GERMANY

RITTERSHAUS RECHTSANWALTE

tokens, dealing with tokens or publicly offering tokens must give careful consideration to whether the tokens constitute a regulated instrument, i.e. for instance a financial instrument within the meaning of section 2 subsection (4) of the WpHG, or a security within the meaning of section 2 (1) of the WpPG, so that they can fully comply with any legal requirements. The duty to comply with legal provisions is particularly relevant with regard to possible authorization requirements pursuant to the German Banking Act (Kreditwesengesetz - KWG) the German Investment Act (Kapitalanlagegesetz - KAGB) the German Insurance Supervision Act (Versicherungsaufsichtsgesetz - VAG) or the German Payment Services Supervisions Act (Zahlungsdiensteaufsichtsgesetz - ZAG).'

In cases where a central issuer utilises cryptocurrency as a mere substitute for legal tender, the tokens might be qualified as e-money according to the Payment Services Supervision Act. In consequence, the issuer would need BaFin's permission to launch an ICO.

In March 2019 the German start-up Bitbond was the first company granted permission by BaFin to issue bonds in the form of security tokens by way of an STO (security token offering). The respective bonds run for ten years and promise 4% interest per year. Both the interest payments and any repayment of principal are made in the cryptocurrency Stellar Lumens.

This is the first time BaFin has approved a prospectus for a security token offering according to the WpPG. Bitbond has been licensed as an investment broker pursuant to the KWG for about two years. The company arranges loans to self-employed and small entrepreneurs on a worldwide basis. It converts fiat currency into cryptocurrency and sends it to the recipient country, where it can then again be exchanged into the local legal currency.

GERMANY

RITTERSHAUS RECHTSANWALTE

5 Please provide any additional information you feel is important to understanding ICO and Token Sale regulation in your country.

German authorities take a very restrictive approach in regard to ICOs and token sales, driven by major concerns regarding issues of consumer and investor protection.

In November 2017 BaFin published a consumer warning relating to the risks of ICOs and token sales, emphasising the following issues:

- ICOs are a highly speculative and risky form of investment which bear the risk of total loss of the invested funds.
- The lack of statutory regulation and regulatory control may attract criminals and often lead to fraud, money laundering and the financing of terrorism. Such illegal businesses are fostered by the anonymity of the internet and the possibility to initiate ICOs and token sales from across the world.
- Codes may contain programming errors and thus may be susceptible to manipulation and exploitation by third parties. Accordingly, the private digital key which is required by investors to access their tokens can be stolen. The loss of this key or its theft means the loss of all tokens which are connected to it.
- White papers which explain the functioning of the tokens and the terms and conditions of the ICO are often non-transparent. The information provided is often incomprehensible or even incorrect and thus misleading, and almost always insufficient to accurately assess potential risks. Understanding the mechanisms of an ICO project would mostly need extensive and in particular technical knowledge.
- Consumer protection does not exist.
- Tokens can be subject to significant price fluctuation.

GERMANY

RITTERSHAUS RECHTSANWALTE

In addition, there is often a risk that no secondary market is available, so that tokens end up being completely illiquid. These circumstances may result in the worthlessness of the investment.

- ICOs and token sales are typically made in a very early stage of business in order to raise capital and finance costly projects. However, the business models are mostly experimental and their performance has never been tested. Products which shall be developed by means of the fundraising ICO may not be developed at all or, if developed, may not find the anticipated demand.

BaFin therefore advises investors that they need to ensure they fully understand the mechanisms and functioning of the respective token before making such an investment, and therefore requests that the offerer provides sufficient information and an adequate level of transparency.

Shortly after the release of the above-mentioned BaFin warning, the German Government released a consumer warning relating to unlawful marketing practices of cryptocurrencies, stating that many ICOs turn out to be illegal Ponzi schemes. It further points out that consumers are not protected by EU law if they purchase goods and services via cryptocurrencies; cryptocurrencies can be subject to high volatility; there is a lack of protection mechanisms such as deposit insurance; and there is a lack of cybersecurity mechanisms to protect trading platforms. Finally, the anonymity of the internet may even be an incentive for fraudulent conduct.

In view of the increasing importance of ICOs and token sales in the German market, it is somewhat surprising that the German Government still did not initiate a legislative process at national level to establish a regulated framework for ICOs and token sales. In its comprehensive blockchain strategy for 2019 in its

GERMANY

RITTERSHAUS RECHTSANWALTE

'Implementation strategy of the Federal Government for shaping digital change' ('Umsetzungsstrategie der Bundesregierung zur Gestaltung des digitalen Wandels'), which was recently announced, the German Government failed to address the issue of regulating cryptocurrencies. Instead it referred the responsibility for regulating ICOs and token sales to the European Union and the international level.

Therefore, it seems unlikely that Germany will regulate ICOs and token sales any time soon.

6 If a foreign entity conducts an ICO and offers tokens to residents of your country, will your government require the foreign entity to comply with any rules and regulations? If so, please provide an overview of how ICOs conducted by foreign entities are regulated by the government of your jurisdiction.

If the ICO falls into one of the categories which is subject to regulatory approval (see question 4), i.e. it is an issuer from a non-EU member state which so far has no subsidiary in the EU, it has to establish a German subsidiary in order to apply for the necessary permit, in particular the authorisation as a credit institution or financial services institution or the approval of a sales prospectus for a public offer of tokens.

If the issuer already has a subsidiary in an EU member state, it can make use of the EU passport rules, and in this case BaFin will examine whether the permits issued by the other EU member state are sufficient to cover the intended activities in Germany.

7 What is the legal nature of crypto in your country (for example, is crypto considered a security, commodity, currency etc.)?

The classification of cryptocurrency in Germany is highly controversial and somewhat contradictory.

In December 2013, BaFin classified Bitcoins and comparable virtual currencies as 'units of account' (Rechnungseinheiten) and thus as a 'financial instrument' (Finanzinstrument) according to section 1 paragraph 11 of the German Banking Act (Kreditwesengesetz (KWG)), a federal law which is not based on EU law.

However, the Higher Regional Court (Kammergericht)

GERMANY

RITTERSHAUS RECHTSANWALTE

of Berlin recently disregarded BaFin's classification and held that cryptocurrency could not be considered 'units of account' and thus not as 'financial instruments' and, in the opinion of the court, as a consequence no permit as a financial service provider pursuant to section 32, paragraph 1, sentence 1 of the KWG is required for operating a trading platform.

Along the same line, the Federal Ministry of Finance also rejected BaFin's classification of Bitcoins as financial instruments and rather defined them as 'other intangible assets'.

However, the ruling of the Higher Regional Court of Berlin does not prevent BaFin from upholding its own classification and, where necessary, starting investigations and imposing fines on issuers and investors. Legal challenges of any decision by BaFin are both very time-consuming and expensive, and the chances of success are relatively low. As explained in question 4, BaFin examines in each individual case whether cryptocurrencies or tokens are financial instruments within the meaning of the German Securities Trading Act or the Markets in Financial Instruments Directive, a security within the meaning of the German Securities Prospectus Act or a capital investment within the meaning of the German Capital Investment Act.

8 Has the government of your country prosecuted, civilly or criminally, any ICO issuers, token developers or crypto exchanges for violating your country's laws? If so, please provide an executive summary of the most significant prosecution(s).

The most important case related to cryptocurrencies is the aforementioned ruling of the Higher Regional Court of Berlin dated 25th September 2018. In this case the public prosecutor had filed criminal charges against the operator of an electronic trading platform where investors could sell and purchase Bitcoins, who had not applied for a permit as a financial service provider pursuant to section 32, paragraph 1, sentence 1 of the KWG.

The mining of Bitcoins also was the subject of two

GERMANY

RITTERSHAUS RECHTSANWALTE

further criminal proceedings. On 29th October 2014 the Regional Court of Kempten heard a case (6 KLs 223 Js 7897/13) in which criminals created and used an illegal bot network for obtaining substantial computing power in order to create new blocks in the Bitcoin blockchain and to thereby receive new Bitcoins. The accused was sentenced to three years of imprisonment according to section 202a (data espionage), section 263 (fraud), section 263a (computer fraud), section 269 (forgery of data intended to provide proof) and section 303a (data tampering) of the German Criminal Code (Strafgesetzbuch (StGB)). Another offender, who was convicted in a separate trial by the Regional Court of Kempten (13 Ss 360/16), appealed against the decision. The case came before the German Federal Court of Justice (Bundesgerichtshof), which mainly upheld the Regional Court's ruling on 27th June 2017 (1 StR 412/16) convicting the accused according to sections 202a, 303a, 236, 263a and 269 of the StGB.

In addition, BaFin as a regulatory agency can also impose administrative fines upon the issuer of up to €10 million for intentional and up to €5 million for reckless violation of the aforementioned laws.

Finally, the Consumer Protection Agency of the German state of Hesse is currently conducting investigations against 20 different distributors of cryptocurrencies related to six different currencies based on consumer complaints.

9 In your country, are there any significant commercial disputes or civil cases (non-government) involving crypto? If so, please provide an executive

The Regional Court of Berlin is currently hearing several civil claims for damages brought by investors against the German start-up Envion AG. Envion's idea was to offer mobile mining pools in the form of lorries or mobile containers which could be placed next to an energy source in order to reduce the immense energy costs usually incurred in an ICO. In order to finance its project,

GERMANY

RITTERSHAUS RECHTSANWALTE

summary of the most significant dispute(s)/ case(s).

Envion conducted an ICO itself in early 2018 in which about 30,000 investors purchased tokens for US\$1 per token, and the company raised more than US\$100 million. However, it turned out that Envion AG had no valid business concept and, in addition, the tokens were sold to private investors without seeking BaFin's approval of the prospectus prior to the ICO.

In addition to the civil claims filed by the investors, the public prosecutor has also initiated criminal proceedings against both the CEO and the shareholders of Envion AG who are accused of having set aside collected assets.

10 Does your jurisdiction tax crypto transactions? If so, please provide a basic explanation of how and at what rate they are taxed.

The taxation of cryptocurrencies in Germany raises complex issues.

According to the BFM, a company that holds cryptocurrencies as operating assets, regardless of whether they are part of the fixed or current assets, has to observe the valuation provisions of the income tax act.

According to section 2, subsection 1, number 2 of the German Income Tax Act (Einkommenssteuergesetz (EStG)) any income of a commercial enterprise is subject to taxation. For the purposes of the EStG, section 15, subsection 2 clarifies that an independent sustainable activity, undertaken with the intention of making a profit and presenting itself as participation in general economic traffic, may be considered as a commercial enterprise.

The process of mining is likewise a commercial activity and treated as the production of any other economic good with regard to taxation.

Furthermore, the administration and operation of an electronic trading platform where cryptocurrencies can be sold, purchased or changed into fiat legal tender is a commercial activity and thereby subject to taxation.

GERMANY

RITTERSHAUS RECHTSANWALTE

Based on the ECJ ruling in Hedqvist, issued on 22nd October 2015, the German Ministry of Finance (Bundesfinanzministerium) released a guideline regarding the imposition of VAT on cryptocurrencies, dated 27th February 2018, where it held that:

- the exchange of cryptocurrencies into fiat is exempted from VAT.
- the mere use of cryptocurrency as an instrument of payment cannot be considered as a transaction triggering VAT.
- the process of mining does not fall into the tax regime of VAT.
- offering digital wallets for a fee can be considered as an electronically provided service according to section 3a, subsection 5, sentence 2, number 3 of the German Value Added Tax Act (Umsatzsteuergesetz (UStG)) and thus constitutes a taxable act.
- Operating a platform to exchange virtual currencies for a fee is a taxable act.

11 Separate from ICOs, does your jurisdiction regulate crypto trading or crypto exchanges? If so, please provide an overview of the regulation.

Market participants who provide services relating to tokens, trade in tokens or offer tokens publicly are required to verify accurately whether the tokens can be regulated as a financial instrument within the meaning of the German Securities Trading Act, or a security as defined by the German Securities Prospectus Act, in order to fully comply with any legal requirements. The obligation to comply with the legal requirements applies in particular against the background of possible licensing requirements according to the German Banking Act, German Investment Act, Insurance Supervision Act or Payment Services Supervision Act.

12 Does your country offer any unique or important benefit to crypto-focused

Currently, there are no specific benefits for crypto-focused companies in Germany.

GERMANY

RITTERSHAUS RECHTSANWALTE

companies (for example, clear regulatory guidance)? If so, please describe the unique/important benefit.

13 Please identify a point of contact at your firm for cryptocurrency-related matters.

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