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Crypto Assets Service Providers MiCA is around the corner!

On the 4th June 2018, the Republic of Cyprus along with 21 other Member States and Norway agreed to sign a Declaration creating a European Blockchain Partnership for the specific purpose of establishing a European Blockchain Services Infrastructure. The ambition and underlying purpose of this European Blockchain Partnership, was to support the delivery of cross-border digital public services, enhance the security and privacy of this sector and (although not expressly stated) to prevent any potential calamities in the financial-blockchain sector.

One offspring of this movement was the much-debated Markets in Crypto-Assets Regulation (**MiCA**). It must be noted from the outset of this article, that MiCA has not yet passed as a Regulation by the European Parliament however, its final and agreed form is already available for inspection to the public.

As the explanatory memorandum of the said regulation states, MiCA aspires in:

“...ensuring that the EU financial services regulatory framework is innovation-friendly and does not pose obstacles to the application of new technologies”

Based on the above consideration, MiCA lays down uniform rules across the European Union aiming at developing a trusted, secured and resilient environment for the regularization of:

- (a) the transparency and disclosure requirements for the issuance and admission to trading of crypto-assets;
- (b) the authorisation and supervision of crypto-asset service providers and issuers of asset-referenced tokens and issuers of electronic money tokens;
- (c) the operation, organisation and governance of issuers of asset-referenced tokens, issuers of electronic money tokens and crypto-asset service providers;
- (d) consumer protection rules for the issuance, trading, exchange and custody of crypto-assets; and

(e) measures to prevent market abuse to ensure the integrity of crypto-asset markets.

What is important to note at this point, is that for the first time in “blockchain history” an attempt is made to regularize the blockchain sector and to assign legal definitions to notions and/or concepts which until recently were considered to be in realm of argot language. Some of the most important definitions deal with the legal meaning of concepts such as the distributed ledger technology, the electronic money token, the exchange of crypto-assets for fiat currency, the issuer of crypto assets and of the crypto-asset service provider.

The cornerstone however, of this novel regulation (at least from a legal point of view), is the definition of “crypto-asset” and more importantly of what can legally qualify as a crypto-asset.

Crypto-Assets

MiCA defines crypto asset as a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology.

In addition to the above-mentioned definition, MiCA distinguishes crypto assets into three sub-categories, namely:

“Asset-Referenced Token” which is defined as a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets.

“Electronic Money Token” which is defined as a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender.

“Utility Token” which is defined as a type of crypto-asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token.

It is important to note at this point, that security tokens are not captured by the ambit of MiCA, as these are captured by the directive on markets in financial instruments (MiFID II) and are treated as financial instruments.

Issuing of crypto-assets – The requirement for white papers

For the issuing of “Asset-Reference Tokens”, Electronic Money Tokens and Utility Tokens, issuers under MiCA are required to draft white papers that satisfy certain requirements.

Accordingly, and *amongst others*, white papers shall contain:

- (a) general information regarding the issuer and a presentation of the main participants involved in the project's design and development,
- (b) the project that is going to be offered to the public as well as the reasons why the crypto-asset will be offered to the public,
- (c) the characteristics of the offer to the public and in particular the number of crypto-assets that will be issued, a detailed description of the rights and obligations attached to the crypto-assets and the procedures and conditions for exercising those rights,
- (d) the information on the technology and standards applied by the issuer as well a detailed description of the risks relating to the issuer of the crypto-assets.

In addition to the above, appropriate risk warnings must be included that caution prospective investors of the fact that crypto assets are high risk instruments, that may lose their value, that they are not always transferrable and that crypto assets by their very nature and/or specific characteristics may not be liquid and/or easily liquidated.

What becomes evident from the above information, is that the requirement to draft white papers for the issuing of crypto-assets can be seen to be akin and/or is comparable to the issuing of a prospectus when a public company intends to proceed with a public offering. However, and as it becomes clear from the above requirements, the drafting of white papers is generally a much more relaxed process and comes with lesser and easier to satisfy formalities when compared to the drafting of prospectuses for public offerings.

Taxation of Crypto-Assets

As the matters currently stand, any funds derived from initial coin offerings relating with crypto-assets are deemed to be taxable income and thus are taxed (in the case of companies) at the standard rate of 12.5%.

In relation with the VAT treatment of crypto-assets, the case of Hedqvist C-264/14 provided the basis for the VAT treatment of transactions concerning the exchange of traditional currencies for bitcoins and vice-versa.

Accordingly, in the case of Hedqvist the European Court of Justice (ECJ) decided that the exchange of traditional currency for units of the 'bitcoin' virtual currency and vice versa, in return for payment of a sum equal to the difference between, on the one hand, the price paid by the operator to purchase the currency and, on the other hand, the price at which he sells that currency to his clients, constitute the supply of services for consideration. However, the ECJ found that this supply of services is exempt from VAT.

Crypto-Asset Service Providers

MiCA makes it clear that Crypto-Assets services shall only be provided by legal persons that have a registered office in a Member State of the Union but more importantly, provided that such persons must have been duly authorised to operate as crypto-asset service providers by the respective competent authority in their home member state.

As the reader may appreciate, the requirement for authorisation imposed by MiCA has a direct effect for Crypto-Asset Service Providers operating in the Republic of Cyprus as the requirement, up and until the writing of this article, has been for crypto-assets service providers to merely register with the Cyprus Securities and Exchange Commission (**CySEC**) and adhere to certain capital requirements which vary depending on the nature and extent of their services.

Organizational Requirements as regards Crypto-Asset Service Providers

Article 54 of MiCA, lists the information that must accompany an application for authorisation of a crypto-asset service provider. Article 61 sets out the organizational requirements that need to be adhered to. What is apparent from the reading of these sections is that the regulation employs similar requirements as those in the cases of Investment Firms (MiFID II) and Alternative Investment Fund Managers (AIFMD) a fact that clearly indicates the level of professionalism the legislature wishes to safeguard.

Accordingly, MiCA provides that members of the management body of the crypto-asset service providers shall have the necessary good repute and competence, in terms of qualifications, experience and skills to perform their duties. In addition, members of the management body of the crypto-asset service provider shall demonstrate that they can commit sufficient time to effectively carry out their functions. Furthermore, natural persons who either own, directly or indirectly, more than 20% of the crypto-asset service provider's share capital or voting rights, or who exercise, by any other means, a power of control over the said crypto-asset service provider shall provide evidence that they have the necessary good repute and competence. Both requirements closely resemble the requirements found in MiFID II and the AIFMD.

Capital Requirements

| Crypto-Asset Service Providers | Type of crypto-asset services | Minimum Capital Requirements |
|---------------------------------------|--|-------------------------------------|
| Class 1 | Crypto-asset service provider authorised for the following crypto-asset services: –reception and transmission of orders on behalf of third parties; and/or –providing advice on crypto-assets; and/or –execution of orders on behalf of third parties; and/or –placing of crypto-assets. | €50,000 |
| Class 2 | Crypto-asset service provider authorised for any crypto-asset services under class 1 and: –custody and administration of crypto-assets on behalf of third parties. | €125,000 |
| Class 3 | Crypto-asset service provider authorised for any crypto-asset services under class 2 and: –exchange of crypto-assets for fiat currency that is legal tender; –exchange of crypto-assets for other crypto-assets; –operation of a trading platform for crypto-assets. | €150,000 |

Passporting of the crypto-asset services

Another important aspect of MiCA that is worth highlighting, is the ability of crypto-asset service providers to provide cross boarder crypto-asset services throughout the European Union.

As Article 58 currently stands, crypto-asset service providers that intend to provide crypto-asset services in more than one Member State, will be able to do so provided that they submit certain information to the competent authority of their home member state.

More particularly, the following information shall be submitted:

- (a) a list of the Member States in which the crypto-asset service provider intends to provide crypto-asset services;
- (b) the starting date of the intended provision of the crypto-asset services;

(c) a list of all other activities provided by the crypto-asset service provider not covered by MiCA.

Crypto-asset service providers may start to provide crypto-asset services in a Member State other than their home Member State at the latest 15 calendar days after having submitted the aforementioned information.

Final Remarks

As stated in the preamble of this article the regularization of this sector is premised upon the sheer ambition of the creation of a trusted, secured and resilient European Blockchain Services Infrastructure and MiCA is perceived as one step closer towards the materialisation of the said expectation. What remains to be seen is whether MiCA will in fact boost investor confidence and provide the much desired and needed assistance for this newly developed sector to flourish and mature.

MiCA is intended to be voted by the European Parliament in April 2023 and is highly anticipated by market participants and industry players alike.