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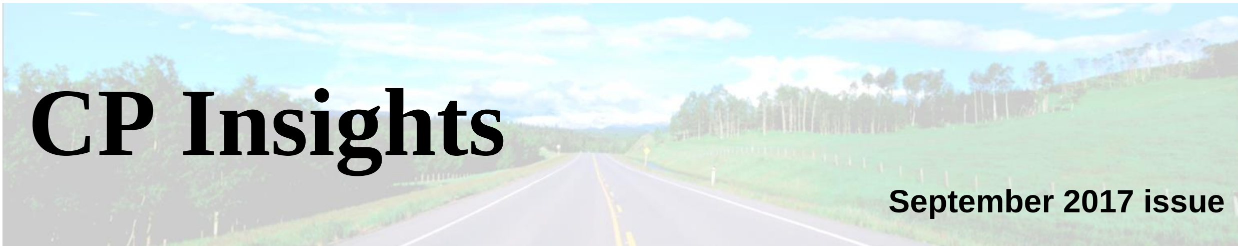

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Bitcoin - The Digital Currency and its Regulatory Issues

A Discussion on Bitcoin and how governments around the globe view it

Introduction to Bitcoin

What is Bitcoin?

Bitcoin is a form of digital currency that is being traded and held electronically with no tangible form. Bitcoin is unique to other currencies in the sense that it is decentralized, denoting that no single institution could own or control it. It is the first cryptocurrency the world has ever known and has several beneficial features.

Firstly, the transaction fee is much lower as you can transfer this currency to another person with relative anonymity without going through a bank nor a clearing house.

Secondly, there are no geographical limitations of the usage of Bitcoin. For the abovementioned reasons, Bitcoin has been a storm in the currency market and the number of users has been soaring over the years since its creation.

The Creation and Operation of Bitcoins

New coins are created through mining, a process of running sets of electronic verification processes to verify the electronic signatures and validate Bitcoin transactions. This provides the requisite security for the public ledger of the Bitcoin network. To mine, each user has to download a special mining application on their computers. Miners, utilizing the mining application, contribute computational power to solve complex math problems and approve transactions (completing a block) in exchange for a certain number of Bitcoins. Mining also helps keep the Bitcoin network safe by ensuring the accuracy of the transaction data in the ledger, also known as the "Blockchain".

Blockchain is a public ledger of all Bitcoin transactions that have ever been executed. The Bitcoin network collects all the Bitcoin transactions made during a set period and construct them into a list, which is called a "block". Once a block is completed, it goes into the blockchain as permanent database. Such blockchain technology serves the basis of the Bitcoins' operation.

Acquisition and Storage of Bitcoin

There are several Bitcoin exchanges which allow the public to buy and sell Bitcoins on the platform using different currencies. Bisq, Coinbase, Xapo are some notable examples of international Bitcoin exchanges. People can also transfer Bitcoins to others by using mobile devices or computers. Bitcoins will be stored in a virtual bank account, as known as "digital wallet", allowing Bitcoin owners to pay for goods.

How is it regulated worldwide? (Singapore, EU and US)

Singapore

In Singapore, the Monetary Authority of Singapore ("MAS") has stated that virtual currencies per se have not been regulated, but the offer or issue of digital tokens in Singapore will be regulated by the MAS if the digital tokens constitute products regulated under the Securities and Futures Act (the "Act"). For instance, digital tokens may be considered as shares or units in a collective investment scheme when it represents ownership or a security interest over an issuer's assets or property. Digital tokens may also be taken as a debenture under the Act when they represent a debt owed by an issuer. Only under these circumstances, will the MAS interfere and require the relevant persons to go through standard licensing process for market operators and financial advisers.

The MAS has also stressed its concern over the alarming inherent money laundering and terrorist financing risks due to the anonymous nature of the transaction and the high liquidity of the currency that enables huge fund raisings within a short period of time. Issuers and intermediaries of digital tokens in Singapore are therefore expected to face intensive scrutiny for their anti-money laundering and counter-terrorist financing ("AML/CTF") controls. Nevertheless, Singapore remains open to the entry of virtual currencies into the country. In the correspondence to the Singapore-based Bitcoin trading platform Coin Republic in 2013, the MAS has expressed that "whether or not businesses accept Bitcoins in exchange for their goods and services is a commercial decision in which MAS does not intervene".

European Union (EU)

The European Central Bank has stated that virtual currencies do not possess the legal status of currency or money but are merely accepted by natural or legal persons as means of exchange. The European Parliament has further proposed that virtual currencies cannot be anonymous.

However, the European Court of Justice ("ECJ"), the highest court of the EU, has ruled in 2015 that Bitcoin transactions "are exempt from VAT (value-added tax) under the provision concerning transactions relating to currency, bank notes and coins used as legal tender". This could imply the ECJ views that buying Bitcoin is a currency exchange instead of a property purchase and that the ECJ treats Bitcoin the same as other legal tender for taxation purposes.

Different EU members have different treatments on Bitcoin and other digital tokens, including setting up legislation to subject virtual currencies to capital gains tax or income tax. This can indicate that different parties of the EU have not reached a consensus on the nature and treatment of Bitcoin yet. Nevertheless, it is agreed across the board that virtual currencies are becoming increasingly popular, not only among the general public, but also money launderers and terrorists. Therefore, establishing a proper regulatory regime over virtual currencies and their intermediaries is of uppermost priority.

United States (US)

According to the US Internal Revenue Service, Bitcoin holders are subject to property tax and Bitcoin transactions should be reported for tax purposes. This could infer that the authority takes Bitcoin as property instead of currency for the purpose of federal taxation.

In 2013, the US Department of Treasury defines Bitcoin as "an example of a decentralized virtual currency". Similar to other governments regulators and central banks, the statement has gone on to raise grave concerns on the money laundering vulnerabilities of virtual currencies.

In a federal case over hacking attacks against JPMorgan Chase & Co and other companies, U.S. District Judge Alison Nathan in Manhattan has ruled that "Bitcoins are funds within the plain meaning of that term" and "Bitcoins can be accepted as a payment for goods and services or bought directly from an exchange with a bank account. They therefore function as pecuniary resources and are used as a medium of exchange and a means of payment". Similar views have been shared by Jed Rakoff, Senior United States District Judge of the United States District Court for the Southern District of New York.

In view of the above, the various US government functions are still unclear in defining and regulating Bitcoin.

How is it regulated in HK?

In Hong Kong, Bitcoin and other virtual commodities remain in a regulatory limbo, without new legislation and explicit guidelines from the regulators in relation to the legal and regulatory status of these virtual currencies. This may be due to the fact that the virtual currencies have limited circulation and hence have yet to pose a material threat to the stability of financial system yet.

On 16 January 2014, the Securities and Futures Commission (the "SFC") has issued a circular regarding the cryptocurrencies, but only highlighted the money laundering risks caused by the anonymity of Bitcoin transaction and lack of central repository of transaction records. It has demanded heightened money laundering compliance processes in transactions involving cryptocurrencies in order to comply with the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

In addition to the SFC circular in 2014, the Hong Kong Monetary Authority (the "HKMA") has also issued a press release in 2015 to restate the stance of HKMA towards Bitcoin. The HKMA believes that Bitcoin is not a legal tender but purely a virtual "commodity" as Bitcoin does not have any backing for its value and the price volatility is extremely high. The HKMA has also stated that Bitcoin and other virtual commodities (collectively "cryptocurrencies") are not regulated by the HKMA.

However, in light of the increasing use of initial coin offerings ("ICO"s) to raise funds in Hong Kong and elsewhere, the SFC has recently warned that digital tokens offered or sold may be deemed "securities" as defined in the SFO and hence subject to the securities laws of Hong Kong. The SFC has observed that certain ICOs have terms and features similar to securities. Since the digital tokens offered in an ICO represent equity or ownership interests in corporation, they may be viewed as "shares". Digital tokens can also be used to represent a debt or liability owed by issuer such that they can be treated as a "debenture". When token proceeds are used to invest in projects to generate returns for token holders, the digital tokens may be function as an interest in a "collective investment scheme" ("CIS").

Therefore, dealing in or advising on digital tokens or managing a fund investing in such digital tokens may constitute regulated activity and hence require a SFC license. Yet, the SFC's stance on the licensing requirement concerning digital tokens is still very ambiguous.

Conclusion

Given that Bitcoins have exploded in its popularity over past months, countries like United States, Singapore and other European countries have issued new regulatory policies on cryptocurrencies with the aim to curb possible money scams or money laundering activities.

We agree the need for different regulatory authorities to enforce certain regulatory actions on Bitcoins so as to better protect the users and manage risks. On the other hand, financial and technological innovation requires government incentives and support. Imposing too many regulations may deter the potential development of cryptocurrencies. Therefore, whether Bitcoins should be subject to the same level of scrutiny as equity securities is a question to be addressed.

If you have any further questions regarding this issue of CP insights or have any topics you would like us to cover, please submit your response here: https://goo.gl/forms/gDLVThTmxGvMl4r12.

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