



Blockchain Assets Pty Ltd — Submission to Australian Treasury's Review into Initial Coin Offerings

This paper forms part of [Australian Treasury's review into Initial Coin Offerings \(ICOs\)](#). The Treasury invited interested parties to make submissions on any or all aspects of the issues raised in their paper by 28 February 2019.

Definitions and Token Categories

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

There is no clear way to define an ICO, but Chris Burniske in his book [Cryptoassets](#) makes a good attempt and we tend to use the nomenclature in that book.

By tokenizing 'real world' assets they become programmable, this exponentially multiplies the combination of properties that can be found in assets. In addition, this technology enables the fractional ownership of assets on a scale we have never before experienced. So not only will the number of assets explode, but the number of asset people own will multiply exponentially. At this time, seeking to arrive at a series of definitions which puts these new assets into boxes we understand today is like trying to categorise all the world's animals after week one of the [Cambrian explosion](#).

There are two unique features of tokenized assets that which makes the process of defining them difficult.

1. 'Real World' assets of the same type will have many hundreds of differently programmed properties.

For example, a tokenized portfolio of French Impressionist Paintings (FIP) may have embedded smart contracts which provides the holder with a small fee each time a visitor enters the actual (and/or virtual) gallery, thus token holders enjoy a revenue stream while they hold the token and hopefully a gain at the time they sell the token. The FIP token may also give the holder the right to vote on which paintings the portfolio manager should buy or sell.

A similar tokenized portfolio of Early American Modernists (EAM) may have embedded smart contract that provides no revenue stream and no voting rights, but it does give the holder the opportunity to visit the highly secure Manhattan Penthouse where the paintings are stored at any time and an annual invitation to the 'Token Holders Visitation Event'. The private penthouse gallery is also available for exclusive private token holder events throughout the year.

So here we have the same type of 'real world' asset (expensive art) wrapped up in digital contracts/tokens with very different properties. The problem from a definitional perspective is that there we are used to defining assets based on the properties of the asset. However, with this new technology it is possible to have an infinite number of different properties and combinations of properties. We have not had this type of problem before with asset classifications as existing technologies have forced us to pick and choose the properties from a narrow range of possibilities.

It's a bit like defining [music genre](#), where once there were a few there are now hundreds.

2. The project tokens themselves many have different programmed properties.

Take the EAM token example, the smart contract with each token may provide that the more tokens held, the more rights you have as a holder. There may be VIP areas and exclusive viewings, you may be able to hire out the art for your own home, or you may as a small holder, owning say only \$100 worth, be able to enjoy free entry at 'sister' galleries around the world.

Here then we have the very same real world asset sliced up into potentially hundreds of millions of tokens each with potentially different properties. Again this has not been possible before, it is like different classes of shareholders but on a far wider and more complex scale, this is what the DLT/tokenized economy can and will facilitate.

Recommendation 1

For now we recommend either leave the law as it is or as a minimum adopt the FINMA definitions see [blog post here](#).

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

This is a human rights question. In Australia it should be beyond question that humans have the absolute right to trade freely with each other, if a new technology enables freer and more fluid trading opportunities it should not at all be prevented from developing. [See here](#).

Recommendation 2

Work with existing Australian crypto exchanges and businesses to help them become licenced under existing laws. Reduce barriers to entry, use existing anti competition laws to open capital markets to cryptocapital market operators.

Refer to [this blog post](#) highlighting the work of [RMIT Blockchain Innovation Hub](#) on the question of capitalism in a post Satoshi environment.

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

Institutional adoption then mainstream adoption. See this [blog post on institutional adoption](#).

Opportunities and Risks

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

This could be a five page answer.

There are hundreds of humanitarian based ICO projects ,involving everything from banking the [unbanked](#), to [identity](#) to [land title](#) to [world poverty](#). Closer to home in Australia we can see a number of use cases in welfare, indigenous art provenance, provenance for brand Australia and many others.

Creation of [non-fungible tokens](#) in of itself creates a whole new industry and ways for creators to capture the value of their creations.

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

It's a little bit like asking, in 1993, what does email do that a letter does not? [See blog here](#)

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

We do not know yet what will become crypto/blockchain native businesses (although [Decentraland](#) and [Cryptokitties](#) are early examples), like the internet in 1994 we did not know what business would be internet native (Facebook etc.).

What we do know is that blockchain native businesses will surpass in value today's internet giants and what we would like to see is a number of those businesses being Australian based.

See [blog here](#) about the significance of blockchain to the economy.

3.4. How important are ICOs to Australia's capability to being a global leader in FinTech?

In our view the development of DLT over the next two decades is biggest wealth creation opportunity in the history of humanity. Australia as a country and Australians as individuals have the chance to participate in this opportunity.

Even more important than wealth creation, DLT has the ability to significantly enhance democracy, freedom and liberty. However, it can also be used to achieve the opposite, it is therefore of paramount importance we are aware of how this technology works as the decisions made now will impact the quality of freedom enjoyed by future generations ([see here](#)).

Also on a point of terminology there is a difference between FinTech and DeFi, [see here](#). Our answers are based on the future of DeFi.

One of the most interesting DeFi projects is MakerDAO project. A [study of this project](#) will offer great insight to how the future of capital markets may unfold. There are two excellent podcast [here](#) and [here](#) which cover the nuts and bolts of the project.

In the second podcast there is a good discussion around regulatory aspects of the project.

Cryptoasset management is a significant area of regulatory uncertainty. It seem from our interactions with the [ASIC Innovation Hub](#) that there is insufficient capacity to properly assess new models of cryptoasset management. Take for example the cryptoasset management platform [Iconomi](#). The Iconomi team have a well documented administration manual, but it is quite different from traditional compliance manuals as the ways of custody and many other things are fundamentally different. We could do with a ASIC sponsored fit/gap analysis on the Iconomi compliance manual.

Consider also a wallet like [ABRA](#) where in the not too distant future individuals will be able to buy and sell all types of stocks and assets on their mobile phone without going through an intermediary.

There are too many DeFi projects to list but one other of note is the [Dharma protocol](#). This project is a borderless platform for issuing, funding, and administering debt assets using a set of smart contracts.

Questions for regulators are : is the MakerDAO a Money Lender, Bank or Financial Institution, could it apply for an e-bank licence in Australia? Is the 'stability fee' tax deductible...taxable to MakerDAO? How will 'Underwriters' and 'Relayers' (in the Dharma protocol) be treated from a regulatory perspective? How can cryptoasset management projects like Iconomi become regulated in Australia?

Recommendation 3

Everyone in the blockchain space is playing catch-up, at our firm, we spend 4–5 hours every day researching developments across the entire ecosystem and even then we are only just keeping up.

We believe Australia could benefit from having a Centre of learning/education for blockchain/DLT technology within the Federal Government. We recommend an internationally based team of advisors to include people like [Michael Casey](#); [Peter Van Valkenburgh](#), [Vinya Gupta](#); [Caitlin Long](#); [Bill Tai](#) and a number of others we could recommend. Plus of course some Australian based advisors, one or two from each State/Territory.

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

Australia should be fully aware of what Russia ([see video here](#)) and [China](#) in particular are doing in the blockchain space. As a free country Australia should be leading the world in making sure open, permissionless and public blockchains are central to international developments.

[This podcast](#) sets out some of the human rights issues of blockchain technology. Blockchain technology could enable the greatest advancement in human freedom and liberty, or it could be the perfect big brother enabler. Australia needs to understand this issue because decisions made now will impact the freedom and liberty of generations to come and once liberties are lost they will be very difficult to retrieve.

[See here for our view on the Australian National Blockchain project](#).(although our view on this project has softened since we published this article, we remain sceptical).

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?

Yes.

At present the entire institutional investment community is not participating in the emergence of the distributed/tokenized economy. This is true in jurisdictions outside Australia, even in places like Singapore and Switzerland. The reasons for a lack of adoption are captured in [this article](#).

We, however are expecting US institutions to start investing in cryptoassets before the end of 2019 ([see blogpost here](#)), but we expect that Australian institutions will stay on the sidelines for at least the next five years, this will be harmful to Australian economy generally but specifically to Australia's desire to participate in the DeFi evolution.

Just on a basic point. It seems obtaining an AFSL for a crypto asset management is not possible at the moment. ASIC will not entertain such an application. Also it seems Australian banks shun crypto businesses going so far as to shut accounts.

Recommendation 4

ASIC should open itself for crypto business and the Australian Bank's should be prevented from closing crypto business related bank accounts.

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?

We set out below a theoretical list of assets for a 25 year old person with no financial background in the year 2021.

| CryptoFolio | Value |
|--------------------------------|----------|
| French Impressionist Paintings | \$235 |
| New York SOHO Property | \$1,378 |
| Gold Bullion | \$546 |
| Bitcoin | \$4,356 |
| Ethereum | \$5,467 |
| Mimblewimble | \$598 |
| Basic Attention Token | \$1,546 |
| Paris Cafes | \$456 |
| US Securities | \$722 |
| US Bonds | \$456 |
| Seoul CBD Office Buildings | \$239 |
| London Theatres | \$197 |
| TOTAL | \$16,196 |

25 Year Old's Cryptowallet in the year 2021

These assets could have been purchased during a public offering or in the secondary market. Or simply swapped using an swap service (like [shapeshift](#) or [ABRA](#)). The manager/promoter of the project could be [centralised, decentralised or distributed](#) and they could be based in Australia or elsewhere. Each one of the assets in the portfolio can be traded (at any time without notification or permission from any one) directly to a peer using a decentralised crypto exchange or a wallet. Or any of these assets could be used as a means of exchange for goods and services.

The 25 year old does not consider themselves an investor and this list is not considered an investment portfolio, it is just of a list of assets temporarily held by the 25 year old, some are held because they like French Paintings some are held because a friend said New York property will go up and some are held to pay for goods and services.

So how do we protect the 25 year old from holding bad assets. The approach thus far is :

1. Define who we are protecting: the Consumer and the Investor
2. Define the thing we are protecting them from : unfair contracts, unfair practices, unconscionable conduct and misleading or deceptive conduct; and fraudulent financial products and services.
3. Set out who we are protecting them against : all businesses that operate in Australia; and Corporations.
4. Set out laws and regulations requiring businesses and corporations to disclose fully all aspect of the product/investment they are selling/reselling. In some cases ensure sellers/resellers have licences issued by the Govt. or professional body.
5. Enforcement is by audit/inspection.

Is this model fit for purpose in the distributed/tokenized economy?

The definition of who we are protecting has not changed and broadly what we are protecting them from has not changed. However, what has changed is the number of assets available and the easy with which they can be acquired. This leads to points 3 and 4 above, where the environment has changed significantly.

Point 3 is significant as we may not have a 'who' to protect them against in a distributed/tokenized world and even if we do have a who, if they are outside the Australian jurisdiction, we may have an enforceability issue.

Point 4 is even more significant because the DLT technology enables projects to offer themselves to the market well before they would have been able to under the existing public offering platforms/systems. The real question then is how to educate a 25 year old person with no financial background, to understand the risk/reward ratio, or even to consider different levels of financial risk?

Recommendation 5

We note that a number of jurisdictions have issued [health warnings](#) to the public about the risks of ICO investing. Such initiatives, if well balanced in messaging, are welcome. We would like to see ASIC go one step further here and develop a globally focused list of fraudulent ICO/crypto scams. Most people in the crypto markets can detect a scam in under 30 mins of research and the globally community calls them out often. This project should be open sourced and decentralised, just like all good blockchain projects, and it should be global.

[Bitconnect](#), for example, was very well and widely known as a scam within the crypto world, yet many Australians got caught up it is because they refused to dig a bit deeper. There is no Govt. site where such scams can be called out. We need a new method of enforcement (point 5 above) the audit/inspection method will not work at all in the distributed/tokenized economy.

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

They say that the last adopters of crypto assets will be middle and lower income people in the first world. This is partly because the existing investment/financial platforms work reasonably well. But it is also partly because issuers may simple deny access to the investment opportunity due to the compliance needed to on-board retail investors.

New York is a great example of how to NOT welcome ICO projects. The [Bitlicense scam](#) has been well documented and the SEC's approach to ICO's has seen many issuers exclude low to middle income earners in the US from participation, meanwhile ultra high net wealth family offices are amongst the most active ICO investors.

In terms of what may work, we believe a strong education around scams plus an official list of scams would be a good start. If ASIC cannot even identify and publish a list of crypto scams at this point, no amount of new rules and regulations will help protect the 25 year old, unless the 25 year is banned completely from participation.

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 requirement will help regulators feel good about themselves but will not work at all to prevent fraud and bad operators. Bad operators can easily publish a Code of Conduct and then proceed to defraud people. It is more than a waste of time, bad operators love a good Code of Conduct to hide behind, they set up a sense of false security, particularly if it is regulatory approved.

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

Yes.

The Fed Govt could lead by example here and help Australia become the country it wants to be in the 21st Century. It could do this by adopting public blockchain technology for the delivery of Govt. services.

In our view Public Services should be delivered using a Public Blockchain. There is an important social/philosophical decision that needed to be considered by groups like the [Parliamentary Friends of Blockchain](#) and indeed more broadly across parliament. The decision is whether Govt. service should be delivered on a public or private blockchain.

Recommendation 6

In our view the mantra should be Public Service = Public Blockchain, if not why not. For now the chain of choice would be Ethereum and our recommendation is that an apolitical group of federal government tech savvy administrators be tasked with the responsibility of joining the [Ethereum Enterprise Alliance](#) (EEA) with the view to identifying a public service use case for proof of concept testing. This could be State based, for example, put motor vehicle registrations on the Ethereum blockchain.

We note that the [Ministry of Planning, Development and Management of Brazil](#) has joined the EEA.

But also be aware that not all DLT is blockchain based and a very interesting project called [Hedera Hashgraph](#) should be considered as well as the EEA. Also again be aware of a potentially even more ground breaking consensus protocol called [Avalanche](#).

The point is, back to *Recommendation 3* above, we are all learning in this space and we believe a centre of learning/education at Federal Government level is an important part of engaging properly with this technology.

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?

Not more than existing. But existing impediments are considerable and with crypto it will be much easier to jurisdiction shop, hence the need to improve generally. In this way crypto may be the catalyst for general reform of taxation.

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

We don't believe the issues are any more complicated. However, once again, because of the ease with which the assets can be acquired and the sheer number of transactions, the administration for the calculations is complicated.

The \$10,000 exemption for personal use is good but there is confusion around whether it is \$10,000 per year and also whether it is \$10,000 at the time of acquisition or disposal. It is also not clear if there could be separation, for example in one wallet there is \$500,000 for long term investment and in another there is \$10,000 for personal use.

The limit could be say \$100,000 per year for personal use in a segregated wallet. This way people could hold and spend up to \$100,000 per year with no tax complications.

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?

Yes but!

If Govt. adopt blockchain the size of Govt. will reduce so the need to tax will reduce, however, the collection mechanism for tax could be embedded into blockchain

projects. Ultimately where the tax system will go is a tax on each transaction on a blockchain.

In time it will be possible to have an international code that sets out rules for which transactions are considered Australian based and to have a way of identifying those transactions so that a micro crypto transaction tax can be collected and paid. The ATO could have a leadership role in developing transfer pricing type treaties that apply to blockchain based transactions. It would be possible to split tax among multiple jurisdictions on a real time basis.

A blockchain based transaction tax system would do away for the need to lodge tax returns and a taxation department, but this is a many years off dream. But we do like to dream.

Ian Love, CEO Founder, Blockchain Early Opportunities Fund