Official Response to Treasury on Initial Coin Offerings
Submission by Jet Yap – CEO of Scratch Cash Pty Ltd

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

There are many creative methods in which ICOs can choose to structure their token properties, and this allows for a project to experiment with novel token economics not possible within a traditional financial instrument framework.

Instead of drafting an Australian unique framework to manage the classification of tokens, and the associated risks, I propose that Australia adopts the concepts laid in the **Conceptual Framework for Legal and Risk Assessment of Crypto Tokens by MME Legal | Tax | Compliance** to rapidly speed up the identification of token categories, and determine the risk profile of each of these token classes to the Australian government's risk appetite.

https://www.mme.ch/fileadmin/files/documents/180501_BCP_Framework_for_Assessment_of_Crypto_Tokens_-_Block_2.pdf

This would rapidly reduce the time and cost taken to identify the majority of the projects out there, and allow for outlier projects with highly unique token properties to be individually assessed for risk.

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

Secondary trading in the market encourages ongoing interest into token projects, as well as allowing "token contributors" to exercise their rights to acquire or dispose their holdings on the project based on the performance of the project against the goals and milestones set forth in their project whitepaper.

This creates both a positive and negative consequence as a result of secondary trading:-
Positive

a) Encourages the project founders to deliver on project goals and milestones to maintain the confidence of the market participants
b) Creates vibrant participation of general public through sustained interest from trading activities
c) Allows for unique properties such as vested voting on key decisions by projects based on their token holdings and be involved in the project governance

Negative

a) Trading of tokens before any delivery encourages speculation, and creates opportunities for token project founders to initiate an exit scam without any legal recourse for token participants
b) Covered persons/influencers may lose objectivity on their professionalism and misrepresent information to create an artificial impression of a project which they have financial interest in to create opportunities for disposals at inflated value or acquisition at suppressed prices.

Token contributors – Persons who choose to put money or native token cryptocurrency into projects to support a vision or idea proposed by the project team

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

The ICO market in 2016 – 2018 has very broadly been about novel ideas which were driven by the desire for:-

a) Disintermediation – and reducing middlemen who had monopolies in the current market
b) Building shared infrastructure – i.e. native token projects which aim to solve specific problems in existing technologies and industries

The key drivers for the ICO market going forward can encompass the following areas:-

a) Accountability – projects that deliver would gain the respect of token contributors and market participants
b) Social change – project that encourage humans to collaborate for a greater cause
c) Global participation – be involved in projects and causes which transcend borders
d) Accessibility – Tokenized assets can be fractionalised and improve financial inclusion at all levels of society

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

ICOs serve best to create value in the public blockchain system through participation and inclusion. Through a network effect, a larger portion of society can be reached through ICOs, and innovators are able to create a shared infrastructure that would be impossible to fund through traditional funding models.

Scientific progress are done through experimentation, and the ICO model allows for experiments to be conducted much faster, spurring innovation from the shared learnings from all the participants.

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

Existing funding mechanisms are largely only available to accredited investors and venture capitalists. Although this is done with the best of intentions by regulators, this also made capital less available to innovators, and reducing opportunities for revenue neutral projects to succeed.

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

The intangible opportunities offered by ICOs are social participation, which may lead to positive societal changes desired by the Australian government, and sentient beings.

Through the involvement of larger groups of society in the fundraising, execution and monitoring of a project's lifecycle, social outcomes are more likely to succeed. Other benefits include additional insights made possible through the use of public blockchains, enabling academics and researchers to perform social sciences study accurately and supported by data.

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

Global youth today highly value geographic mobility, flexible working arrangements, and living with a cause. ICOs offer the opportunity for Australia to attract talent, capital and ideas into Australia.

Talent and thought leader interactions with the Australian economy intimately encourages innovation in Australia.

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

The biggest issue with ICOs that policymakers and regulators should be cognizant about are:-

1) Excessive fundraising – projects raising ridiculous amounts of money without any qualified/reasonable assessment of overall project cost
2) Embezzlement – project founders who misappropriate funds for personal benefit betraying the trust of the token contributors
3) Insider trading – syndicates affecting secondary markets with unpublished information provided by the project team

4.1. Is there ICO activity that may be outside the current regulatory framework for financial products and services that should be brought inside?

Tokenised physical assets – Any form of tokenized physical assets should fall under some form of regulatory oversight or fiduciary reporting

Loan and lending platforms – Any form of lending or credit platforms which requires a trustee to act on behalf of the participants should fall under some form of regulatory oversight or fiduciary reporting

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, the current regulatory framework has not been updated / designed to take into consideration the attributes and traits of ICOs. Existing legal frameworks also do not allow token contributors to exercise legal recourse in the event that token project founders fall short of their commitments, and conduct actions that lead to the risk highlighted in Question 3.5 (excessive fundraising, embezzlement, and insider trading).

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

Safe harbour exemptions should be introduced to classify low risk token projects, either based on category or amount raised. These exemptions can be regularly revised with input/consultation from industry participants, as well as regular polls with token contributors to reflect the overall risk appetite of the ecosystem participants.

Legal frameworks to address the risks posed by project founders should be made available to token contributors to hold project founders accountable in the situation where the use of funds deviate significantly from the whitepaper.

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?

Principles based governance are appropriate due to the fast evolving nature of the ICO industry, particularly as there is insufficient data and precedence to allow for a thorough prescriptive based code of conduct.

The code of conduct prepared and submitted by industry participants would better reflect the issues and concerns experienced. Regulatory oversight and fiduciary reporting should be made mandatory, with crucial issues requiring regulatory approval.

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

The biggest issue faced today is the lack of understanding of the underlying blockchain technology, and exuberant claims made by ICO project marketing operators. Education and awareness are crucial to a well-functioning ICO market in Australia and should be an ongoing activity across all age sectors.

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

Yes, the current tax treatment poses massive accounting and financial impediments for issuers in capital raising activities. The extremely volatile nature of the cryptocurrency market can be made worse with mandatory liquidation of raised assets to solidify a tax position. The tax treatment of funds raised during an ICO that are deemed as revenue also incorrectly reflects the transaction that took place.

The funds raised resembles funds held in trust for the purpose of executing the objectives and goals set forth in the whitepaper, and should be recognized as a liability until the product has been delivered.

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

The current tax treatment assumes capital gains/losses on liquidation of a non-cash token into another non-cash token, which may not carry the presented monetary value when liquidated. This puts the entire market at risk, particularly at the end of financial year, when all token participants liquidate their holdings in order to solidify their tax position to cover their tax obligations.

A token that has recently floated on a secondary market is highly susceptible to shocks and crashes as a result of mass liquidation by token holders.

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. Tax treatment on capital gains/losses should only take place when an ICO token or cryptocurrency is converted into fiat currency or equivalent of a fiat currency such as stable coins.

The primary justification for this is that gains/losses is only properly realised and recorded in the financial system when it’s converted to/from cash such as the Australian dollar.

Any form of token exchange between two parties on non-tangible tokens without a stable market value is subjective in nature. Introducing tax treatment on these token transactions may result in opportunities for tax evasion through manufactured capital losses.