

FINDING THE IDEAL JURISDICTION FOR AN ICO

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INTRODUCTION TO THE COMPANY AND THE ICO

Fundastik (the “Company”) is a fin-tech innovative company that intends to build a global investment supermarket and become the Amazon of investments. The Company identified that the current situation in the market does not meet the individual investors’ needs from their banks and brokers. The Company proposes a disruptive investment tool for the individual investors’, who are looking to build their own diversified investment portfolio, which will be:

1. User friendly and easy to build.
2. Independent from banks, brokerages, fund managers.
3. Visually comparable to other portfolios.
4. User experience based on social networks and gamification.

The Company intends to go on an ICO (Initial Coin Offering) during 2018. The main reason for going on an ICO is the fact that the success opportunities in an ICO, for the company, are extremely higher than an ordinary IPO, mainly due to the fact that the company has not yet proven any financial record. The ICO’s white-paper is currently being prepared. In order to attract the investors to put their funds and invest in the Company as part of the ICO, the Company should declare (as part of the White-paper) the type of token it will issue to its investors. There are different token types, and basically, every company can decide and create a different token. However, most of the tokens are classified to one of three different type of tokens:

1. Equity tokens – Tokens, which are similar to issuing a stock in a regular IPO. These tokens give access to the investor to be part of the Company and hold a certain percentage of the company.
2. Security tokens – These type of tokens are any kind of token which is tradable. Through ICO’s, investors have access to a wide variety of securities tokens from various types. As a principle rule, most of the ICO tokens will fall under the definition of “security tokens”, since most of the investors in an ICO, will invest due their expected profit on this investment.
3. Utility tokens – These type of tokens are also called “app coins” or “app tokens”. The tokens provide the investors with access to a product or a service. The interesting part about utility tokens is that their total supply is fixed (The total number of utility tokens must be reported in the white-paper of the ICO). For this reason, their value may appreciate over time if the demand for the product or service increases.

Following the Company’s decision to go on an ICO, the Company must decide on the jurisdiction, as well as the optimized tax structure, that will bring the company the most benefits from the ICO.

Following a discussion with Attila Halmai, Fundastik Founder, it was decided that the main points should be clarified, before deciding on the actual jurisdiction and the tax structure that the Company should initiate for the ICO:

1. which is the best location for making an ICO?
2. Tax issues: what kind of taxes should be paid after the ICO if any?
3. What is the best tax structure the Company should form?
4. What are the costs and time frame of founding and running a company in the above mentioned jurisdictions?
5. Any special requirements to run an ICO company in the above mentioned jurisdictions?

In order to answer the above mentioned questions and decide on the jurisdiction that the company should perform the ICO in, I investigated the current situation for ICO’s in 7 different countries:

LITHUANIA

Lithuania has an exceptional regulatory advantage, as it is one of the first EU countries to establish a comprehensive guideline on the legal framework for ICO projects, covering regulatory, taxation and accounting aspects of the ICO’s.

Tax rates	<u>CIT</u> – The normal rate is 15%. (Could be less in few cases). The funds from the ICO should not be taxed, due to the fact that the company will raise “utility tokens”: “ <i>Tokens which grant the right to use a product or services by paying in tokens; the funds generated this way are considered as advance payment to be included into future contributions. The issue of tokens designated for acquisition of goods and services is considered as only a transfer of cash, and not as an earned income.</i> ” They will be taxed, however, when they are utilized by the investors. Another important factor is that the tokens, which are designated to the founders in the ICO process, will not be subject to income tax as well (until they are sold by the founders, which will then have to pay the relevant tax). <u>VAT</u> – The normal rate is 21%. Tokens are seen as a form of a currency, so VAT may not apply.
Entity costs	Typical corporate registration fee is 290 EUR, and the share capital minimum is 3,000 EUR. Timing varies, but typically 5-12 business days.
Special requirements	Lithuanian resident involvement is usually required, depending on the entity type. Typically will include a resident director and a resident auditor for the entity. Establishing a bank account is relatively costly with strict KYC controls.

ESTONIA

Estonia, following the launch of their e-Residency program in 2014 and the current development of their own national token offering (the “Estcoin” project), has become a major hub for ICO’s. However, there is still no formal guidance on income tax for ICO proceeds.

Tax rates	<u>CIT</u> – The normal rate is 20%. As mentioned above, there’s no formal guidance on income tax from ICO raised funds, but the funds are recorded in the books of the entity as assets in the balance sheet, and corporate profits are usually taxed only when they are distributed. For this reason, raised funds from an ICO should not be taxable. In addition, there is zero taxation on dividend income, and profits reinvested in the entity are not taxed. <u>VAT</u> – The normal rate is 20%. VAT is unlikely to capture typical ICO’s.
Entity costs	The typical corporate registration fee is 190 EUR. The minimum share capital is 2,500 EUR. The timing for setting up the entity is 5-15 business days usually for simple companies (for ICO related companies, it may take some additional time, depending on the advisory team and the perceived compliance risk of the ICO).
Special requirements	The e-Residency regime enables a corporate setup administration without physical presence in Estonia. (100 EUR fee for registration). The whole process can be done in a couple of hours.

SWITZERLAND

Many large-scale Initial Coin Offerings have recently been conducted in or from Switzerland. The country enjoys a history of bank confidentiality and political stability that brings many investors to initiate their ICO’s in the country. In February, 2018, the Swiss Financial market authority published the official ICO guidelines for the country. Typically, ICO’s founded in Switzerland use a Swiss non-profit foundations (“stiftungen”), as a subsidiary of the parent company. The ICO funds are collected by the foundation, who then distribute it to the parent company when it is necessary. This foundations pay usually less taxes than other corporates in Switzerland.

Tax rates	<u>CIT</u> – The normal rate varies between 12%-24% (depending on the region). According to the guidelines (issued by the Swiss Financial market authorities on February, 2018), the tax liability of an ICO is derived from the 3 different types of tokens issued: 1. Payment token - Tokens, which are used for value transfer (like a regular currency) – In this case, the ICO proceeds are likely to be a taxable income for the issuer. 2. Asset tokens – Tokens that represent a financial asset – These tokens are similar to a stock or a bond because they are likely to grant rights for the holder of the token in the company. These tokens will be taxed in a similar way that other equity devices are taxed in Switzerland. 3. Utility tokens - Tokens which provide their holders a right for a digital access to an application or service. In most cases, the issuing entity realizes an income from the ICO proceeds, which is generally taxable. <u>VAT</u> – The normal rate is 7.7%. Similar to CIT, it depends on the specific ICO and the nature of the token sold.
Entity costs	Typical corporate registration fee is 120 CHF. The minimum share capital (of a GbmH or a S.a.r.l, which are the often used entities for an ICO in Switzerland) is 20,000 CHF. Timing is usually 8-15 business days, but could be higher for ICO related companies.
Special requirements	For a typical entity, it is required to have at least one resident director.

SINGAPORE

Singapore is a key player in the ICO industry, as the city-state has positioned itself strategically as a global hub for cryptocurrency and blockchain-based ventures. A typical ICO structure (whether in Singapore or elsewhere) entails that the issuer be set up as a foundation, which in Singapore is usually done in the form of a company limited by guarantee. This entity is usually designed to carry out certain non-profit making activities that have some basis of public interest.

Tax rates	<u>CIT</u> – The normal rate is 17%. The Singapore tax system is semi-territorial in nature. “ <i>Corporate income tax is payable at the rate of 17% upon: (i) Income accruing in or derived from Singapore; and (ii) foreign-sourced income to the extent that it is received in Singapore.</i> ” An issuing entity based in Singapore may argue that the proceeds from an ICO are foreign-sourced income . With this characterization, the ICO proceeds are not subject to Singapore tax as long as they are not received or deemed to be received in Singapore. A foreign-source argument is more likely to be successful if the developers behind the block chain technology are based outside Singapore , the ICO is marketed outside of Singapore via participation in industry events and on the internet generally and the participants in the ICO are predominately from outside of Singapore. However, this argument is very hard and complex to achieve. <u>VAT</u> – The normal rate of GST (Global and Service Tax), which is the VAT equivalent of Singapore, is 7%. It seems like ICO structures might be captured by GST, depends on the token issued.
Entity costs	Typical corporate registration fee is 315 SGD. There is no minimum share capital. Timing of registration a company is typically 5-15 business days, but could be more for an ICO related entity.
Special requirements	There is a minimum of one Singapore resident director required.

GIBRALTAR

Gibraltar has not yet introduced a formal regulation for ICO’s, but has publically announced its intention to do so. Gibraltar has been attracting many ICO’s for several years due to its low-tax offshore jurisdiction. During 2017, over 3.5 billion USD were raised in the small country, mainly due to low tax rates and the fact that the country is perceived as a global center for offshore banking.

Tax rates	<u>CIT</u> – The normal rate is 10%. In March, 2018, the Gibraltar government published a whitepaper, and according to it, we can assume that utility tokens represent a deferred income, and should not be taxed. <u>VAT</u> – The normal rate is 0%.
Entity costs	Typical corporate registration fee is 100 GBP. The minimum share capital is also 100 GBP. (In case it is a Non-resident/ offshore company there is no minimum share capital). Timing of registration a company is typically 5-10 business days, but could be more for an ICO related entity.
Special requirements	There is a Non-resident company regime, allowing company to be setup without any residence substance. Another important advantage of Gibraltar is the fact that it belongs to the EU, which may attract investors to invest in the ICO as well.

The UK

The UK has not yet regulated ICO’s in its jurisdiction. The Financial Conduct Authority (FCA) even issued a warning in September, 2017 to consumers about the “very high-risk, speculative investments” of the ICO’s.

Tax rates	<u>CIT</u> – The normal rate is 20%. In the absence of specific rules, the taxation of the ICO raised funds is determined by the general principles and depends on the various types of tokens issued, but in general they should be taxed. <u>VAT</u> – The normal rate is 20%. VAT is aligned with the CIT treatment of the ICO funds.
Entity costs	Typical corporate registration fee is 100 GBP. The minimum share capital is 50,000 GBP. Timing of registration a company is typically 5-15 business days, but could be more for an ICO related entity.
Special requirements	There is no typical directorship residency requirements for the relevant entity types.

MALTA

Malta is considered by many to be the first country in the world to introduce a clear regulatory framework around ICO’s, tokens and cryptocurrencies. However, Malta does not yet regulate utility tokens. Malta, as an EU member with good reputation of banks and financial sectors became lately a major hub for many ICO’s.

Tax rates	<u>CIT</u> – The normal rate is 15%. In case the token is a utility token, and gives no rights to the investor for
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	the entity, the funds should not be taxed. However, the entity must be very careful in the way it promotes the token, to make sure it still qualifies as a utility token. <u>VAT</u> – The normal rate is 18%, but could also vary in different cases. The VAT aligns with the CIT treatment and depends on the token nature.
Entity costs	Typical corporate registration fee is 245 EUR. The minimum share capital is 1,200 EUR. Timing of registration a company is typically 5-15 business days, but could be more for an ICO related entity.
Special requirements	There is no typical Maltese resident required. However, it is worth to have at least one Maltese resident as a director in order to obtain benefits, depending on the circumstances.

Tax structures of ICO's

The best tax structure for the ICO should be concluded after deciding on the preferred jurisdiction, taking into account many factors, such as: The ICO legal market, the ultimate objectives of the ICO, The commercial/ practical ability to relocate staff, Project components, where is the IP located, where is the key management based, what are the compliance capabilities. There are, however, two common approaches that have emerged in the industry: **1. Foundation approach** - This approach enables the Company to raise their funds to a foundation, which is established in the chosen jurisdiction. A foundation can be suitable to hold token sales and manage the proceeds because: 1. it can be solely established to carry out a purpose (ICO) and not for the benefit of persons. 2. It has many tax benefits in various jurisdictions. (Lower taxes, many tax deductions). 3. It can be considered a non-profit foundation. **2. Offshore approach** - This approach enables the Company to raise their funds into an offshore company, which is established in the chosen jurisdiction. This is a more common approach in jurisdictions like Gibraltar, Malta and Singapore, as these countries are typically offshore countries that form only a part of a large global network of companies. This approach has many advantages, such as: 1. Tax benefits in the offshore jurisdictions. 2. Separate liability between the offshore company (that holds the ICO funds), and the development and project parent companies. (Could be important in case of a legal claim of one of the investors).

CONCLUSION

After examining the 7 different jurisdictions and the specific needs of Fundastik, I believe that the most attractive jurisdictions for the ICO of Fundastik should be:

1. Estonia – Due to the fact that it is considered by many to be one of the most ICO friendliest countries. Establishing a business is quite rapid, there are zero taxes on the ICO funds and it is an EU country, with political stability.

2. Malta – Due to the fact that it is an offshore jurisdiction, with all the low-taxes applicable to an offshore country, but it still has a very good reputation, as an EU country with political stability, and this is an important factor when raising ICO funds from investors.

Another important point for consideration, is the fact that the company haven't yet prepared a white list of all the potential investors. When the white list will be ready, it is recommended that the company will approach the "big" investors and ask them about whether there is a specific jurisdiction that they would prefer that the ICO entity will be established, as the choice of jurisdiction could be crucial for the decision of some of the investors of whether to invest in the ICO or not.

