



Blockchain & Cryptocurrency Regulation

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Russia

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Government attitude and definition

In sum, cryptocurrencies are used in Russia in various contexts including as payment for goods or services or as some instrument analogous to securities. Given the absence of laws which would directly govern cryptocurrency and the generally non-transparent nature of transactions with cryptocurrencies, the Russian authorities have an established negative attitude to their use. However, the Russian legislators have been working on a set of laws which would govern cryptocurrencies. As regards blockchain technology, there is no uniform approach, but in general it has already been used in Russia.

For several years, the Russian authorities have been giving attention to potential uses of blockchain technology and cryptocurrencies. The focus has been on compliance and anti-corruption and anti-money laundering measures. The Central Bank of the Russian Federation (The Bank of Russia) and the Ministry of Finance are the key regulators that have paid specific attention to these issues.

There is no law at present that would specifically address cryptocurrencies, and there is no legal definition of cryptocurrency. On the contrary, there are laws that might be viewed as prohibiting cryptocurrencies in Russia. For example, under the Russian Constitution, the *rouble* is the only means of payment in Russia. Further, under the Federal Law on the Central Bank of the Russian Federation of 2002, the *rouble* is the only national currency, and the introduction of other currencies or the issuance of currency surrogates on the Russian territory is prohibited. Cryptocurrencies may be such prohibited currency surrogates.

Further, there is a view that the use of cryptocurrencies is associated with illegal activities. In January 2014, The Bank of Russia issued an information letter¹ warning that the trading in goods or services for “virtual currencies”, as well as the conversion of such currencies to *roubles* or foreign currencies, could be used for money laundering and terrorist financing. Therefore, any transactions involving cryptocurrencies are subject to heightened scrutiny.

In 2016, the Ministry of Finance proposed amendments to certain laws² that would impose large administrative fines and criminal penalties including imprisonment for up to seven years, for the issuance, purchase, or sale of bitcoins. Certain other Russian governmental bodies expressed support for these proposals, including the Ministry of Economic Development and the Investigative Committee, a federal agency with authority over criminal investigations. However, these proposed amendments have not been introduced.

Nevertheless, cryptocurrencies are used in Russia. Moreover, there are attempts to bring regulation to cryptocurrency. For example, the State Duma, the lower chamber of the Russian parliament, has adopted in the first reading a set of draft laws on cryptocurrency (*see* section “*Cryptocurrency regulation*” for further details). These draft laws propose definitions of a

“token”, “cryptocurrency”, and an umbrella definition for both tokens and cryptocurrency – a “digital financial asset.”

Cryptocurrency would be broadly defined as a variety of digital financial assets created and accounted for in the distributed ledger of financial transactions by the participants of that ledger and in accordance with its rules. In turn, the digital financial asset would be defined as property in electronic form, created using cryptographic means, and which includes cryptocurrency and tokens. “Digital money” would be defined as a digital code or enumeration in a decentralised information system that does not certify rights to any assets, but rather is used for making payments. It is proposed that digital money can be used as payment in Russia in certain circumstances and subject to conditions to be set forth in other laws.

Similarly to cryptocurrencies, there is no law at present specifically addressing blockchain technologies. However, the authorities do not view blockchain negatively. On the contrary, the use of blockchain technologies for the formation and implementation of “smart contracts” is of great interest in Russia and they have already been used in certain areas. In many respects, Russia remains a tradition-bound market in which physical documents are essential. In particular, the transition to distributed ledger systems and virtual contracts will conflict with existing, centralised registers that are now legally required for certain activities and transactions.

However, Russia is moving toward digitalisation of many services and functions that government agencies perform. Governmental authorities are in the process of modernising their operations, allowing filings and document exchange via online platforms – including, for example, filing of tax declarations, accounting reports and licence and patent applications. These include the Federal Tax Service, the Federal Service for Intellectual Property, and the Federal Service for Supervision of Communications, Information Technology and Mass Media. Notary filings may be submitted electronically, and the register of the companies is also accessible online. Still, legal reforms are needed to allow the use of these technologies, and there are various proposals for ways to achieve this.

Cryptocurrency regulation

There is no existing specific regulation of cryptocurrencies, and their use in Russia is currently subject to great legal uncertainty. However, over the last couple of years, different proposals for governing cryptocurrencies and related matters have been announced.

In May 2018, the State Duma (the lower chamber of the Russian parliament) approved in the first reading three draft laws that address the use of cryptocurrencies in respect of mining, token offerings, and crowdfunding:

1. A draft law “On Introduction of Changes to Parts One, Two and Four of the Civil Code of the Russian Federation”, primarily aimed at amending the Civil Code, with core concepts related to cryptocurrencies: “digital rights” and “digital money”.
2. A draft law “On Digital Financial Assets”, that would introduce certain key rules with respect to issuance, offering or otherwise transacting with tokens including initial token offerings (also known as initial coin offerings or ICOs), the mining of cryptocurrency, and the use of digital wallets.
3. A draft law “On Attracting Investments with Use of Investment Platforms”, that seeks to regulate the activities of crowdfunding platforms and related investment activities (collectively, the **Draft Laws**).

The Draft Laws appear to be the first comprehensive attempt to adopt regulations directly governing cryptocurrencies and related matters. However, prior to becoming the law, the Draft Laws would need to be approved by the State Duma in the second and third readings, then approved by the Council of Federation (the upper chamber of the Russian parliament), and signed into law by the Russian President. The second reading has not been scheduled. It appears likely that the Draft Laws will be further considered by the State Duma this autumn. We think that substantial revisions will be made before the second reading, especially because the current versions overlap or even contradict each other in many respects.

Sales regulation

Under the Draft Laws, digital assets may be exchanged only for traditional currencies (*roubles* or foreign currency) through the so-called “operators of digital financial assets trade”. An operator of digital financial assets trade must be a Russian legal entity that is considered a broker, a dealer, or a securities manager pursuant to the Federal Law on Securities Market of 1996 or a trading organiser pursuant to the Federal Law on Organized Trading of 2011.

In addition, the Draft Laws introduce rules for issuing and offering tokens. It is proposed that a token offering would comprise two steps. First, the issuer of tokens disseminates via the Internet an investment memorandum (“white paper”) containing a public offer to purchase tokens and such other documents as the issuer may determine. After the investment memorandum and other documents become public, the issuer can sell tokens to investors, including by means of smart contracts.

The Draft Laws propose certain mandatory requirements for the contents of the investment memorandum and the public offer, to make the process transparent. For example, the investment memorandum must include information on the issuer’s shareholders, the purpose of issuing tokens, the planned use of proceeds (for example, it should contain a business plan for any projects being funded), and the description of rights associated with tokens. The public offer must include information on the issuer, the purchase price (or method of its determination), the rules for maintaining the register of transactions with tokens, and the procedure of opening and maintaining digital wallets. In essence, the proposed rules are similar to the existing rules on issuing and offering securities in Russia.

Taxation

Although there are no special rules on the taxation of transactions with cryptocurrencies, the Tax Code of the Russian Federation would apply.

Recently, the Ministry of Finance expressed a view that all profits from operations with cryptocurrencies should be subject to personal income tax, and issued two information letters in May³ and July⁴ 2018 (the **Letters**). In these Letters, the Ministry of Finance specifically noted, among other things, that any economic benefit derived from transactions with cryptocurrencies is taxable and taxpayers must pay income tax (the tax imposed by the Tax Code); the tax base from cryptocurrency sale and purchase transactions should be determined in *roubles* as a surplus of income received by the taxpayer from the sale of cryptocurrencies over the total amount of expenditures for the purchase of cryptocurrencies; and the taxpayer must calculate the amount of tax to be paid and file the tax declaration himself.

Reportedly,⁵ the amendments to the Draft Laws that are now being prepared for the second reading at the State Duma (see section “*Cryptocurrency regulation*” for further details) will contain amendments to the Tax Code of the Russian Federation on taxation of digital rights.

Money transmission laws and anti-money laundering requirements

There is no express cryptocurrency-related anti-money laundering legislation.

In September 2017, The Bank of Russia issued yet another information letter⁶ warning about possible illegality and associated risks of transactions with cryptocurrencies. The Bank of Russia noted that cryptocurrencies are issued by anonymous and unidentifiable persons and, therefore, in transacting with cryptocurrencies, persons may become involved in illegal activities, including money laundering and terrorist financing. The Bank of Russia warned that cryptocurrencies entail high-level risks, both when issuing cryptocurrency and tokens in initial token or coin offerings, as well as later, during exchange operations. The Bank of Russia further emphasised that it believes that “admission of cryptocurrencies and other financial instruments nominated in or related to cryptocurrencies, to circulation and use in organised trading as well as in clearing and settlement infrastructure for servicing transactions with cryptocurrencies and related derivatives in Russia”, is premature.

Promotion and testing

The Russian Government and The Bank of Russia have launched or announced several initiatives to support the development of blockchain technologies while keeping a watchful eye on the cryptocurrency market.

In September 2015, The Bank of Russia established a working group⁷ to study blockchain technologies and to explore potential practical applications, including in the financial markets. This has led to efforts to establish a prototype distributed database for financial messaging. In July 2016, a consortium including Qiwi, a provider of electronic payment and financial services in Russia and the CIS; Accenture, a global management consulting and professional services firm; and several Russian private banks, began testing⁸ blockchain technologies, working together with The Bank of Russia. The work of the consortium has resulted in Masterchain,⁹ an Ethereum-based blockchain prototype for the validation and exchange of client data and transactional information. In contrast to Ethereum, Masterchain is a permissioned (private) database of chained blocks of data. The Bank of Russia acts simultaneously as an ordinary user in payment processing and as a trusted administrator. The next step may be to develop further prototypes. The Bank of Russia is currently examining two other proposed versions of Masterchain.

Further, in 2017, the Russian President issued an order¹⁰ for the Russian Government and The Bank of Russia to create a regulatory sandbox for testing various innovative financial technologies. The Bank of Russia created the sandbox in April 2018.¹¹ It allows innovative start-ups to test their technologies without running a risk of violating current legislative restrictions.

Another proposal is the establishment of a professional association called “FinTech”,¹² which would assist in drafting legislation to regulate blockchain technologies. Representatives of various governmental agencies would also participate. The association would address various applications of blockchain technologies, such as electronic voting, notary systems, maintenance of shareholder, real estate and other statutory registers, and validation of client data and transactional information.

Several Russian organisations are also becoming active in the blockchain sphere. The National Settlement Depository, Russia’s central securities depository, has initiated a pilot e-proxy shareholder voting¹³ project using a blockchain solution, and has already serviced several blockchain-backed commercial bond offerings.¹⁴

Ownership and licensing requirements

The Draft Laws propose certain regulations regarding ownership and licensing requirements with respect to cryptocurrencies (see section “*Cryptocurrency regulation*” for further details on the status of the Draft Laws).

Under the Draft Laws, ownership of cryptocurrencies would not be specifically restricted, and would be based on a person’s having access to a “digital right” recorded in a decentralised information system, as well as the related records made in the register of digital transactions.

The Draft Laws propose to define a “digital right” as a digital code or enumeration in a decentralised information system that: (a) certifies that a person having “unique access” to such code or enumeration will also have rights to certain assets (other than intangible assets); and (b) allows such person to obtain information on these assets at any time. An owner of a digital right would be a person with “unique access” to such code or enumeration that would allow such person to dispose of the digital right. The Draft Laws also propose that in certain cases, an owner of a digital right could also be a person recorded as such by the person with “unique access” to the code or enumeration.

As regards investments, the Draft Laws propose to introduce a concept of the “investment platform.” An investment platform would be defined as an information system in the information-telecommunication network the Internet, that is used for concluding contracts with the use of information technologies and technical features of the investment platform by means of which investments are attracted, and which is also available as a mobile application. Only a Russian legal entity included by The Bank of Russia into a register of operators of investment platforms may be the operator of an investment platform.

The Draft Laws would also limit investments by individuals who are not considered “qualified investors” under Russian securities laws. Qualified investors are deemed to have sufficient experience in the investment market and include so-called professional participants in the securities market such as broker-dealers, clearing organisations, banks and other financial institutions, securities investment funds, management companies of investment and pension funds, non-state pension funds, The Bank of Russia and other persons which are considered to be, or could be qualified as, “qualified investors” under the securities laws. These could include individuals who meet certain eligibility criteria established by the securities laws. Individuals who are not qualified investors would not be able to invest above certain thresholds to be further determined by The Bank of Russia. At present, similar rules apply for non-qualified investors investing via stock exchanges and otherwise in securities and other financial instruments.

The Draft Laws contain no specific licensing requirements to be imposed on the holders of cryptocurrency.

Mining

The Draft Laws would introduce the definitions of “mining” and “digital record validation”. “Mining” would be defined as actions aimed at creating cryptocurrency, and/or digital record validation for the purpose of obtaining cryptocurrency reward.

“Digital record validation” would be defined as an action of legal significance aimed at verifying the validity of digital records in the register of digital transactions. The validation is supposed to be performed in accordance with the rules on maintaining the register of digital transactions.

The Draft Laws also contemplate that mining of cryptocurrencies would become a taxable

business activity when it exceeds, for three months in a row, certain electricity consumption thresholds to be determined by the Russian Government.

As regards the existing legislation that may be applicable to mining activities, certain hardware used in mining activities may be currently recognised as devices containing encryption and cryptographic tools. Under the applicable laws, the use and distribution of such devices may be subject to import restrictions as well as licensing by the Federal Security Service or the Ministry of Industries and Trade.

Border restrictions and declaration

At the moment, the existing laws and initiatives do not provide for any border restrictions or obligations to declare cryptocurrency holdings when entering or exiting Russia.

Reporting requirements

At present, there is no specific regulation with respect to cryptocurrency reporting requirements for individuals or legal entities. However, the issue of reporting has been discussed in the context of Russian anti-corruption laws, requiring public and governmental officials to report on their property and other holdings. These discussions are also associated with another important legal issue: whether cryptocurrency is property.

In May 2016, the Ministry of Labour and Social Security of the Russian Federation issued the reporting guidelines.¹⁵ Notably, in these guidelines the Ministry of Labour specifically advised that public and government officials are not obliged to disclose ownership of “*virtual currencies*”, in contrast to rather strict reporting obligations in relation to their assets and funds on bank accounts. In other words, these guidelines assume that *virtual currencies* are not property.

However, in other spheres cryptocurrency is viewed as property, at least in the insolvency context. For example, Russian courts are already facing difficult questions regarding the nature of cryptocurrencies and their exposure against creditor claims. Recently, the Moscow appellate court has ruled¹⁶ that the concept of “*other property*” as set forth by the Civil Code of the Russian Federation could be interpreted to include cryptocurrency. Therefore, cryptocurrency should be included into the insolvency estate of the debtor along with other property. The court obliged the debtor to disclose his password to give the insolvency manager access to the debtor’s cryptocurrency wallet.

Estate planning and testamentary succession

At present, there are no special rules on succession of cryptocurrency. Still, the rules on succession of the Civil Code of the Russian Federation generally apply, subject to the below considerations.

It is possible that, under the general rules of the Civil Code of the Russian Federation, cryptocurrency could be recognised as an estate property (asset or other property). This has already been supported in court (see section “*Reporting requirements*”, for further details). However, given that access to cryptocurrency assets is restricted to persons having a code or specific “*unique access*”, certain steps should be taken by a person to ensure that the cryptocurrency will be passed to heirs.

Cryptocurrency has two crucial features that prevent existing legal structures from being applicable to the succession of cryptocurrency: (1) that the identity of a cryptocurrency owner is not generally revealed to third parties; and (2) that the cryptocurrency owner is

neither shown in any certificate or other document nor listed in any register.

Therefore, one needs to create an action plan to enable to include a person's cryptocurrency assets to the estate (as it is recognised by the Civil Code of the Russian Federation). In essence, a person needs to set up a structure allowing heirs to inherit tangible media (a piece of property) containing the information allowing access to a cryptocurrency wallet and to transact with the cryptocurrencies stored in it. For example, the person can do as follows. First, determine what information is required to get access to the wallet and transactions with the cryptocurrencies such as, for example, a login and password to a website, a secret question or a key (code). Secondly, fix such information on a physical storage device such as, for example, a USB flash drive, a compact disk, a paper note. A physical storage device would be a piece of property that could be inherited too, including by default. Under the Civil Code of the Russian Federation, estate includes assets and other property, including property rights and liabilities owned by the deceased as of the date of opening of the inheritance.

These steps are relevant only if there are no laws addressing the issue. It is possible that once the cryptocurrency is expressly allowed in Russia, inheritance laws might be amended to deal with cryptocurrencies directly.

* * *

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