

Initial coin offerings (ICOs) in Liechtenstein

Who to contact

Dr. iur. Guenther Dobrauz
Partner, Leader of PwC Legal
Switzerland
+41 58 792 14 97
guenther.dobrauz@pwc.com

Martin Meyer
Director, Leader of Financial and
Private Wealth Services PwC
Liechtenstein
+41 58 792 42 96
martin.meyer@ch.pwc.com

Mark Schrackmann
Assistant Manager, PwC Legal
Switzerland
+41 58 792 25 60
mark.schrackmann@ch.pwc.com

Orkan Sahin
Assistant Manager, PwC Legal
Switzerland
+41 58 792 19 94
orkan.sahin@ch.pwc.com

At a glance

- An initial coin offering (ICO) or a token sale is when a company sells a predefined number of digital tokens to the public in a limited period of time.
- The ICO market has grown very rapidly in recent months and has been a new avenue for blockchain-based start-ups and projects to get the funding needed to launch their projects.
- In September 2017, the Financial Market Authority Liechtenstein (FMA) published a fact sheet on ICOs which stated that depending on their specifications, tokens may constitute financial instruments subject to financial market law.

In detail

1. What are ICOs?

Initial coin offering (“ICO”, also referred to as token generation event, token launch or token offering) is a term describing a limited period in which a company sells a predefined number of digital tokens (crypto coins) to the public, typically in exchange for major crypto-currencies (as of today, mostly Bitcoin and Ether).

On the side of the token issuer, the collected funds are typically used to finance a project (e.g. the building of a software/ blockchain-based platform). In exchange for the financing, the investor receives a token which may be connected with the right to receive a dividend, a voting right, a licence, a property right or a right to participate in the future performance of the issuer. Usually, tokens are tradable on cryptocurrency exchanges.

2. Token characteristics

Tokens (coins) can have different functions, which triggers the way in which we treat them from a legal and regulatory perspective. Four main forms exist to date (including many hybrid combinations).

a. Security token

Tokens with a security character (e.g. debt, equity or derivatives) with an income-generating component and potential rights vis-à-vis the issuer (e.g. governance, participation, ownership).

b. Digital currency

Tokens with an attributed value. They can be used to buy and sell goods and services and can be used to store value (although they can be very volatile).

c. Asset-backed token

Tokens that provide underlying exposure to real world assets (e.g. gold, diamond, securities, cash, real estate, etc.)

d. Utility token

Tokens with a utility character provide access to a blockchain-based platform, product or service. They are not primarily designed as a means of an investment.

3. What are the characteristics of an ICO?

In general, an ICO has the following structure:

- a. Publication of a white paper describing a project or product as well as the funding via ICO. The white paper also describes the intended use of the tokens to be issued. Software and the technical specifications are published on open source platforms like GitHub.
- b. A smart contract is set up, usually based on the Ethereum blockchain. The smart contract is needed to generate and distribute the tokens later on.
- c. During a fixed time period, cryptocurrency payments (usually Ether or Bitcoin) are accepted by way of the smart contract.
- d. Using the public key for those payments (similar to a digital account number), the smart contract generates the new tokens and makes them available to investors.
- e. The tokens may be stored by third parties (wallet providers) and/or made tradable with the help of cryptocurrency trading platforms.
- f. Once the funded project is complete, the investor can sell the tokens or exchange them for services.

4. What are the key challenges of an ICO?

Regulators worldwide are starting to look into ICOs, but only few have actually taken action (e.g. China, USA, Singapore). It is expected that the US SEC/EU ESMA and other major regulators will soon regulate the ICO space, particularly from a capital markets, tax and KYC/AML perspective.

A further challenge is that many ICOs still lack proper **cybersecurity**, which can represent a major threat for investors. As most ICOs raise money in the form of cryptocurrencies, high-volume transactions provide an attractive target for criminals. Besides ICOs, several cryptocurrency wallets (where tokens/coins get stored) have been hacked recently.

5. How does Liechtenstein treat ICOs from a legal/regulatory perspective?

In September 2017, the Financial Market Authority Liechtenstein (**FMA**) published a fact sheet on ICOs which stated that depending on their specifications, tokens may constitute financial instruments subject to financial market law. This may include tokens that have characteristics of equity securities or other investments.

In principle, activities relating to financial instruments are subject to licensing by the FMA on the basis of special legislation and may require publication of a prospectus.

In all cases, the **specific design and de facto function of the tokens** are decisive. Any AML/KYC obligations also depend on the specific design. Connecting factors for FMA jurisdiction exist, for instance, if a company's registered office or branch is in Liechtenstein and/or if relevant activities are pursued on the Liechtenstein market.

6. How is an ICO taxed in Liechtenstein?

Liechtenstein offers a **favourable tax system with modest tax rates** for issuers of tokens (typically using a foundation structure or a special purpose vehicle), for ICO entrepreneurs and for investors.

Careful structuring of the ICO is necessary to manage potential issuance stamp tax consequences (in case of issuance of equity tokens) as well as VAT and corporate income tax consequences (in case of issuance of utility tokens). Since there is no gift tax in Liechtenstein, employing a charitable foundation structure is an option worth considering in detail.

Taxation of ICO entrepreneurs and investors domiciled in Liechtenstein depends on the categorisation of a specific token. Capital gains on digital currency tokens should generally be exempt from income tax (due to taxation of notional income from wealth instead of effective investment income).