San Marino: at the forefront of blockchain

The San Marino Republic is at the forefront of Distributed Ledger Technology and has just published specific blockchain technological legislation for firms. Stefano Loconte reviews

In the last few months the San Marino Republic has been the leader of an ambitious project expressing specific rules for the various technological applications of the Distributed Ledger Technology with transparency, clarity and simplicity, to capture the attention of international investors.

On 27 February a group of experts has been appointed to achieve this objective and, anticipating most of the countries that are operating on this kind of project, Delegated Decree n. 37 of 2019 has been published, dictating specific regulation about the blockchain technology for firms.

Blockchain and ITOs: opportunities and threats

There something clear since a long time: cryptocurrencies and the blockchain technology, basically, represent an epochal change.

The innovations variety offered by the blockchain system doesn't stop, moreover, at cryptocurrencies, but it performs until it absorbs the venturing world and investment of innovative start-up phase firms, which seem to have a very interesting growing potential.

It is, of course, in this context that ICOs (Initial Coin Offering) start playing, a digital financing collection realized through an offer to the investors of a precise new issue of crypto coins quantity - commonly known as token- in return for cryptocurrencies or currencies with legal effect.

Since the goods offered to financiers consist of a virtual coin called token, it is normal to classify ICOs as ITOs (initial token offering). It is absolutely interesting to observe the word ITO which is an acronym of 'Initial Token Offering' or an 'Initial offering of token', an expression used in the stock exchange glossary, where 'Initial Public Offering' means a shares offering of a certain company that needs to be listed on a regulated market for the first time.

In the meantime, ITOs represent a crowd funding amply used nowadays by the start-up firms based on the blockchain to finance particularly innovative projects.

The ITO's diffusion, which impressed the cybernetic world in 2017 and 2018, has been supported by the easy way to collect, even enormous, funds in a few minutes with the absence of the word's instrument.

However, in the meantime, the lack of an ad hoc legislation for this new phenomenon has generated many difficulties considering that the token results more or less subjected to financial market legislation.

San Marino has produced a model of clarity, precision and efficiency which deserves the attention of the market

Therefore, the need for an international regulation has been growing to avoid the potential obstacles represented by the different qualifications carried out by individual countries, as already reiterated at European level by the European Securities and Markets Authority (ESMA), which on January 9th published *Advice to the European Union Institution*, as well as the European Banking Authority (EBA), which on the same day, dealt with the legislation applicable to the crypto assets with the *Report on Crypto-assets*.

This need, together with the one to count on the prevision of a structured and clear ITO's process, bring the operators moving to countries with more specific rules.

This is why an updating of the legislation system of each country, on the basis of the above mentioned technological innovations, represents a powerful engine to increase the competitiveness and each one's positioning in the global market.

As said, the countries' task becomes even more difficult due to the additional problems that the blockchain phenomenon has generated.

First of all, it is not clear what kind of tax treatment applies to cryptocurrency transactions, a question on which European jurisdiction has widely discussed, but which needs a solution from individual national laws.

Secondly, token and cryptocurrency transactions could be used to commit crimes: operations are dematerialized, and take place between subjects who, purchasing and investing all over the world, cannot be easily tracked down. Due to the anonymity an easy exposure to recycling risks is enormous.

The San Marino Republic experience

Behind all the opportunities mentioned above, as well as the criticalities, the clear and prompt approach has to be widely considered and it has been adopted by the San Marino Republic and this aspect will be also described through a comparative analysis.

With a global market that sees blockchain standing at 339.5 million dollars in 2017 and with a growth perspective of 20.3 billion, equal to 2.3 billion, the San Marino Republic has clarified its target: to create an ecosystem for innovation increasing in the Republic and becoming the European blockchain hub.

The project driven by San Marino Innovation (Institute of Innovation of San Marino Republic S.p.A.): a private law company, but exclusively State-owned, able to grant broad spectrum social and economical goals.

The Institute assumed the task to create a clear, precise and understandable legislation on the blockchain technology for firms and on this matter has been appointed a team of experts. The team has studied the various applications of blockchain technology of the main International markets and the related legislative matters and after several months of hard work, on the 27 February 2019, Delegated Decree n.37 was been published.

Delegated Decree nr. 37 of 2019

The main purpose is to attract investors and position the San Marino Republic as the best legislative partner for innovators.

The legislation is aimed at firms and organizations that are operating with blockchain systems, residing not only in the San Marino Republic, but also in any other country member of the European Union, as well as non-EU, as long as it is considered suitable by the San Marino Republic legislation.

Following a specific request by the issuing subject addressed to San Marino's Innovation Institute, the Decree also provides that foreign countries' token issues could be subjected to San Marino Republic's legislation and jurisdiction.

The Decree's main strength is the opening of the ITOs market to foreign issuers without the need for the issuer to have a stable organization in this country: this choice shows a difference between the San Marino Republic's Decree and the other legislations, like the American one in which foreign settlement is essential through a stable territorial organization.

Therefore, after disclosing a specific motion and providing the information and documentation needed for proper checking, those people will obtain recognition by San Marino's Innovation Institute S.p.A. taking advantage of a legal system with high is clear and aligned to the higher tax legislation and standards of compliance.

The Decree faces the most critical aspects in financial, tax and anti-money laundering related to the blockchain technology and the above mentioned ITOs, and regulates them in twelve articles.

The Decree's financial aspects in a compared perspective

With a financial overview, it seems useful to observe that a different approach has been given to the one adopted by the French system which is, instead, directly modifying its own financial text.

On the other hand, similar to the French approach are the criteria to legally qualify and classify the token. Indeed, these criteria join, not only France and the San Marino Republic, but the most part of the countries that are regulating the token, where it could be possible to distinguish the various types on the base of the indications below with an economic and financial classification.

Specifically, the approach of those digital assets, shared not only at European level, but global, on the base of the legal rights they are involved in, have to be classified as follows: 1) Payment token, regulated by the monetary code as normal means of payment; 2) Utility token, that grant the right to access the technology or service distributed by the issuer; 3) Security token, as a financial means.

The document published on 16 February 2018 by the Swiss Financial Market Supervisory Authority is to be remembered and taking into consideration as an example.

Similarly, also in England, as part of the Taskforce launched in March 2018 and composed by the Finance Ministry (HM Treasury), the Financial Conduct Authority (FCA) and the Bank of England to monitor crypto assets sector developments, the opportunity to distinguish between exchange, security and utility token, according to their uses was confirmed.

With reference to the security token, it is, otherwise, interesting to observe how the US uses the Howey test, to understand if a digital asset is connected to a financial instrument.

On the base of this test, the token is used as a financial means in the following conditions: 1) in case of money investment or other equivalent asset; 2) in case of profit agreement, as a consequence of an investment; 3) when the investment is directed at a common business; 4) the investor expects profits connected to the funds management.

Sharing this classification, the San Marino Republic's Delegated Decree firstly provides the global token definition, and then focuses on the two legislation types that could mostly impress firms and the world investors.

These are tokens, qualified as 'vouchers for services or goods purchases offered by the Institution'; and the investment ones, which represent, alternatively, depending on the submitted means, shares, financial means or issuer's equity securities. These last ones are therefore subjected to financial market legislation.

Instead, the San Marino Republic legislator has chosen to put aside (at least for the moment) the token's payment legislation, which represents a residual slice of the reference market.

Illustrating the main regulation aspects for issuing the utility token and investment token dictated by the Decree, the common rules are for both categories, the presentation of a request for the issuance of specific authorization by San Marino's Innovation Institute; the drafting of a whitepaper and a summary note to be delivered to the Institute at least 20 days before the offer; and the obligation to accurately and truthfully sponsor the same token offer.

San Marino's Innovation Institute has the right to request an integration of the information supplied by the Institution every time it is necessary to keep the system credible and transparent and, at the same time, interrupting the offer in case of law violation.

Other clarifications are also required on the offer of investment token: particularly in case of a public offering, a very articulated prospectus has to be published which is relevant to the transaction, the organization, the management and financial situation and the evolution of the issuer's activity, in line with the provisions indicated in the European Legislation and the one of the San Marino Republic regarding business, venture, financial and insurance services.

It is useful to observe how the obligation parameters of the prospectus publication recall those provided by the European Union legislation. It is also very important to note, in a comparative perspective, how the authorization

procedure expected by San Marino Republic is in line with the one adopted by the other countries all over the world.

For example, in the US there is a registration obligation by the financial market regulation, the Federal Authority (the SEC), even if, it is different from the one of the San Marino Republic where registration is not required and it has to be done within the 15 days after the token offer.

In Asian countries, like Singapore, in the case of token issuance the approval of the competent authority is required and in Europe the same obligation is imposed in France and Switzerland (where the competent authority is the FINMA)

Innovative aspects: trust use and tax treatment

Proceeding with the technical analysis of the Decree's features, a forecast seems worthy of attention for innovation and pragmatism.

As a matter of fact, the possibility to create a trust as a way to manage the token issue is expected for the Institutions which realize a starting token offer and jointly or separately, the relationships with the investors and the issuer to put themselves as a market reference.

First of all, this kind of Institute, with Anglo-Saxon origin, permits the increase of the monitoring and the transactions transparency thanks to a trust legislation that in the San Marino Republic is punctual and advanced.

The avant-garde approach adopted towards trusts is the San Marino Republic's strong point: just thinking that in its jurisdiction, it established with the Constitutional Law nr.1 of 26 January 2012, a qualified institution called to settle

all disputes concerning legal relationships arising from custody or trust, regulated by any system (the Court for the Trust and the Trustee Reports)

Furthermore, the decision of the Delegated Decree to use trust as the sole representative towards the issuer permits the resolution of the typical problem connected with the ITOs, to get in touch with a very consistent investor number, the so-called shareholding diffusion.

Otherwise the reflection suggests a comparison with another Anglo-Saxon origin means, even if quite different: the 'Trust Supporters' (also qualified as popular shareholding), widespread in the sports world which consist in the submission of the shareholding property to the supporters who will assume a double role: the one of supporters and the other of investors. Practically, we can assist in the creation of supporter associations and cooperatives which have, among social purposes, the one to purchase shares of their favourite club.

That being said, to analyze a further aspect of the San Marino Republic's blockchain legislation, there is no shortage of the long-awaited tax treatment clarifications which have to be applied to cryptocurrency transactions. It concerns a complex matter that other countries are facing with many different solutions while others have not assumed a definitive position yet.

For example, the US applied the assimilation mechanism: the token type is treated like foreign currency, tax instruments or Commodity. The government tax collection agency has also issued guidelines to help taxpayers in the classification.

On the other hand in Asia, in Singapore, the national tax authority has not clarified yet how the token should be taxed.

On the European front, the situation is quite different: in Luxembourg there is a different tax treatment depending on whether the digital asset is qualified as a means of payment or not: if it represents a payment instrument, the token is treated as a foreign currency and therefore exempted from VAT; if it is used as a means of exchange, the transaction will be subjected to VAT.

Also in Lichtenstein the taxation depends on the specific token category and the capital gains on the 'digital currency token' are exempted from income tax. It is interesting to know that, in case of fundraising which is based on a charitable funds, this is totally exempted because in this country donations are not taxed. On the contrary, in France tax regulation is still being implemented.

In this overview the San Marino Republic legislation stands out for clarity. Without doubt, as a means of tax and trust, utility tokens have to be associated to foreign currencies, while the investment tokens are associated with shares, tax participative means or issuer debt securities.

In addition, concerning debts realized through token transactions regulated by the Decree, it is considered a tax exemption for IGR (General Income Tax).

Anti-money laundering and transparency protection

Lastly, the anti-money laundering provisions and the transparency system deserve particular attention and these problems, as already mentioned, are deeply felt all over the world.

The Bank Secretary Act application in the US has already provided, and in this way, whoever issues and offers tokens to the market has to comply with federal anti-money laundering.

Also Singapore legislation requires strict controls on the issuer and the intermediaries who deal with the placement of the newly issued tokens. Europe, Liechtenstein and Luxembourg confirm the application of strict rules of anti-money laundering to the token exchange and offer operations.

Moreover, also in Italy, even if a specific cryptocurrencies legislation has not been created yet, we have promptly adapted to the standards required by the V European anti-money laundering Directive (Directive (EU) 2018/843, 30 May 2018); the anti-money laundering obligations were extended to include the cryptocurrencies sector, with specific obligations imposed on the exchange platforms too. France, instead, has to adapt to the above mentioned legislation, and has to do it within 2020.

With reference to the San Marino Republic, the Decree of 27 February reveals, also in this field, the maximum seriousness of a country which refuses an indiscriminate access and imposes strict rules to whoever wants to enter in its market defined effectively an ecosystem.

The Decree does not limit itself, providing that transactions are *"subjected to constant checks to fight against money laundering"* but requires further caution. Particularly, the Decree imposes that adequate checking has to be effected in a strengthened form, for instance with the modalities (already promptly contemplated by the San Marino Republic legislation on the matter, with reference to the Law nr 92 of 17 June 2008 and following modifications), used in the most risky anti-money laundering situations.

Only and exclusively, the subjects who in their own jurisdiction are submitted to checking measures equivalent to the adequate checking strengthened by the San Marino Republic legislation could have access to the system and other operations (included the token movement).

In conclusion, San Marino has produced a model of clarity, precision and efficiency which deserves the attention of the market, and could also be profitably followed by other countries. ■

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