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Blockchain Bites: Disney and Sony embracing a Web3 future, ATO crypto guidance draws attention to need for legislative clarity, Hong Kong to tokenise investments, Party amid a rally? AusCryptoCon 2023

Michael Bacina, Steven Pettigrove, Tim Masters, Jake Huang, Luke Higgins, Luke Misthos and Kelly Kim of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Entertainment giants Disney and Sony embracing a Web3 future

In a magical move that's making waves, entertainment juggernaut Disney is stepping into the blockchain realm with the announcement of their NFT collectibles platform, Disney Pinnacle. Partnering with Dapper Labs, the group behind the wildly popular NBA Top Shot NFT marketplace, Disney Pinnacle is aiming to bring collecting and trading of Disney IP into the digital realm.

Much to the excitement of Disney fans and blockchain enthusiasts alike, Dapper Labs Co-Founder and CEO Roham Gharegozlou announced the news on X:

Drawing inspiration from the [iconic pins scattered across Disney's theme parks](), this platform will mint pin-inspired digital collectibles as NFTs on the [Flow blockchain](), the same network that powers the slam-dunk success of NBA Top Shot and [NFL All Day](). Enthusiasts will be able to own a digital pin featuring the charisma of Buzz Lightyear, the beauty of Disney Princesses, or the dark allure of Darth Vader—no longer confined to physical pinboards but securely nestled in the digital universe.

Disney Pinnacle is designed exclusively for mobile, and promises that fans can dive into the world of NFT collectibles with ease. Gharegozlou assured fans that this platform wasn't just a remix of Top Shot; it's said to be a carefully curated platform for the everyday fans and high-end collectors. While the platform is currently twirling on the tip-toes of a waitlist, Gharegozlou stated there will be gradual onboarding process for users to beta-test the experience before its official launch.

As Disney dances into the blockchain spotlight, Sony is also poised to join in the rhythm in what is a powerful duo of the entertainment industry embracing blockchain technology. Just over a month ago, Sony announced that it was partnering with Web3 builder Startale Labs to build their own blockchain. In a recent blog post on the Sony Group portal, Sony announced plans to leverage blockchain beyond the confines of cryptocurrency, echoing a transformative belief in blockchain's potential to reshape social systems.

By harnessing its vast reservoirs of intellectual property across electronics, movies, music, video games, and finance, Sony envisions a future where blockchain orchestrates a harmonious exchange of information. Masaaki Isozu, president of Sony Global Education, believes blockchain has the potential to challenge the established norms of capitalism. Sony Music Entertainment's newest service is called "soundmain", and the company is intending to leverage blockchain technology to manage copyright information.

As Disney and Sony step onto the blockchain stage, the footsteps of these two titans sends a resounding signal to the world—the era of blockchain isn't just a digital spectacle, but has the power to reshape industries. Transcending just cryptocurrency speculation, blockchain as a technology has the potential to usher in a new era of innovation and collaboration.

By Michael Bacina, Steven Pettigrove and Luke Higgins

ATO crypto guidance draws attention to need for legislative clarity

The Australian Taxation Office (**ATO**) has released new non-binding web guidance addressing the taxation of crypto assets for individuals engaging in crypto asset activities.

The newly updated guidance is provided across three subsections, being:-

1. crypto asset transactions with gift cards or debit cards;
2. crypto asset prizes and gambling winnings; and
3. decentralised finance and wrapping crypto.

The ATO's definition of "crypto assets"

Despite the lack of a formal definition of "crypto assets" in the Australian taxation legislation, the ATO has defined "crypto assets" in their non-binding web guidance as:

> …a subset of digital assets that use cryptography to protect digital data and distributed ledger technology to record transactions. They may run on their own blockchain or use an existing platform such as Ethereum…

There are no special tax rules for crypto assets. The tax treatment will depend on how you acquire, hold, and dispose of the asset.

For tax purposes, crypto assets are not a form of money.

The GST Act has a definition of "digital currency" and trading digital currency is largely a GST free activity.

Crypto asset transactions with gift cards or debit cards

The ATO has carved out three particular examples. First, the guidance states that a capital gains tax (**CGT**) event occurs when an individual uses (i.e. disposes of) crypto assets to acquire a gift card. This CGT event occurs regardless of whether the gift card is denominated in AUD or crypto assets.

Example: acquiring a gift card with crypto assets

Raj buys 50 ABC tokens for $50. Raj later uses these tokens to buy a $100 gift card. A CGT event happens when Raj buys the gift card, as he disposes of 50 ABC tokens in exchange for the gift card.

Raj has a capital gain of $50.

A CGT event also occurs when loading or topping up a gift *or* debit card using crypto assets. If an individual transfers crypto assets to the digital wallet of the gift or debit card provider for the purpose of loading or topping up the card, the transfer of the crypto assets into that digital wallet is a deemed CGT disposal. The proceeds for this CGT event are equal to the amount by which the available balance of the card is increased (in AUD equivalent).

Example: loading a debit card using crypto assets

Yindi has a debit card that is linked to her crypto wallet. Yindi uses her debit card to buy a television for $2,000.

The debit card provider draws crypto assets from Yindi's crypto wallet and converts them to AUD to pay to the merchant.

The capital proceeds for the disposal of crypto assets are $2,000.

The release of this particular guidance is timely, given the increase in the number of "crypto debit card" like products being offered on the market today (see for example CryptoSpend, the Crypto.com VISA Debit Card and the Binance Visa Card).

Where taxpayers use a gift or debit card that is denominated in crypto assets, the AUD value of the available balance changes as the price of the crypto assets change. The ATO provides the following example of how such dealings may be taxed:

Example: using a gift card denominated in crypto assets

Olivia has a gift card denominated in XRP. Olivia paid 500 XRP to acquire the gift card and it has an available balance of 500 XRP.

At the time Olivia acquired the gift card, XRP had a market value of $1 [per XRP].

Olivia uses the gift card to buy a guitar costing 400 XRP.

At the time Olivia acquires the guitar, XRP had a market value of $0.95. Olivia has a capital loss of $20 and a remaining balance of 100 XRP on the gift card.

This creates complexities for individual taxpayers using crypto asset denominated cards. Given the inherent volatility of crypto assets, taxpayers should be aware of the compliance (record keeping) burden is placed on them when transacting with their card as the price of crypto assets can change rapidly and often dramatically.

Crypto asset prizes and gambling winnings

Subject to certain situations, prizes won in ordinary lotteries (like lotto draws and raffles) and on game shows are not generally considered ordinary income. The ATO guidance states that individuals usually do not need to include details of capital gains and capital losses made directly from gambling or prize games, a re-statement of the ATO's findings in Taxation Ruling IT 2584. It is important to note that individuals who dispose of CGT assets (e.g. investments) for gambling purposes still have a CGT event.

If an individual wins a crypto asset, the ATO guidance states that that individual may hold the asset won as an investment. In such circumstances, the ATO states that the eventual disposal of that crypto asset may be subject to CGT, with the cost base of that crypto asset being its market value as of the time of the win.

Example: crypto asset won in a lottery is held as investment

Anwar pays $100 for tickets in an online lottery where the prize is crypto assets. Anwar wins the lottery prize of $20,000 worth of crypto assets. The winnings from the prize are not ordinary income and any capital gain is disregarded.

Of course, any gains on the price of winnings of crypto-assets when sold later will still be assessable for tax.

Decentralised finance and wrapping crypto

The ATO defines decentralised finance or "DeFi" as:

a blockchain-based form of finance that is conducted without relying on a financial intermediary (peer-to-peer)

The ATO warns that CGT events can arise in a DeFi environment, usually in the form of CGT events A1 (Disposal of a CGT asset), C2 (Cancellation, surrender and similar endings), E2 (Transferring a CGT asset to a trust), or H2 (Receipt for an event relating to a CGT asset). Contentiously, this can be the case even where an "equivalent" transaction or dealing takes place in a non-DeFi environment (i.e. with "traditional finance" assets or arrangements like lending and borrowing). The ATO states that CGT events occur in DeFi scenarios as the beneficial ownership of the relevant crypto asset ends due to the arrangement.

The ATO also expresses a view that a CGT event will generally arise where an individual taxpayer transfers a fungible crypto asset (for example, ETH or a similar ERC-20 compliant token) to an address that the individual doesn't control and/or that already has a balance of the same fungible crypto asset. In this scenario, the capital proceeds from the CGT event are equal to the market value of the asset received by the taxpayer in return for transferring the crypto asset.

The ATO provides the following example of a lending arrangement with a DeFi platform:

> **Example: CGT treatment when you lend to a DeFi platform**
>
> Mika buys 100 ZYX coins for $1,000 and 'lends' them to a DeFi platform.
>
> The terms of the contract are unclear about whether Mika retains beneficial ownership of the 100 ZYX coins. The DeFi platform pools the ZYX coins that Mika 'lends' at the same address as the ZYX coins it receives from other 'lenders'.
>
> As ZYX coins are fungible, a CGT event happens in respect of Mika's ZYX coins at the time of the initial 'loan'.
>
> Under the contract, Mika has a right to receive 100 ZYX coins from the DeFi platform at a future time. At the time Mika receives the right (being the time she made the initial 'loan'), each ZYX coin had a market value of $9. Mika's right was valued at $900, so she has a capital loss of $100. Mika's right has a cost base of $900.
>
> Three months later, the 'loan' is repaid and Mika's right to receive 100 ZYX coins from the DeFi platform is satisfied by the transfer of 100 ZYX coins to her. At that time the market value of each ZYX coin is $10, so Mika makes a capital gain of $100. Mika now has acquired 100 ZYX coins with a cost base of $1,000.

On the topic of liquidity pools and providers, the ATO states that a CGT event happens when an individual deposits crypto assets into a liquidity pool. The capital proceeds of this event are equal to the market value of the property received by the tax payer in return for deposited crypto assets. When the individual withdraws the crypto assets from the liquidity pool, a CGT event occurs in relation to the crypto asset or a right received from the original deposit, with the proceeds being equal to the market value of the withdrawal.

> **Example: exchange of crypto asset through the liquidity pool**
>
> Martha is a liquidity provider who deposits one EH to the XA liquidity pool. In exchange for the one EH, she receives 20 XA tokens representing her share of the liquidity pool.
>
> Martha acquired the one EH 3 years ago at a price of $2. The 20 XA tokens have a market value of $20 at the time of contribution.
>
> The deposit of one EH into the liquidity pool is a CGT event. Martha has a capital gain of $18. Martha may be eligible for the CGT 50% discount.

Finally, the ATO deals with the controversial issue of wrapped tokens. The ATO defines wrapped tokens as a "tokenised representation of another crypto asset". Wrapping is essentially a function that allows a user to use the value of their crypto asset on another blockchain. By way of analogy, it is like allowing a PC game to run on a Mac computer – it won't work properly unless you have special software.

Despite the contention from tax professionals that a wrapping event should simply be a non-taxable activity performed to provide software compatibility to a token, the ATO considers that a wrapping event creates a CGT event. Under that logic, when individuals wrap or unwrap a crypto asset, they exchange one crypto asset for another and a CGT event happens. The capital proceeds from this CGT event equal the market value of the wrapped token at the time of the exchange. The ATO provides the following example:

> **Example: CGT treatment when exchanging wrapped tokens**
>
> Kal bought 1 BTC for $60,000 in January 2022 and then wrapped it through a smart contract for 1 WBTC in April 2022.
>
> The market value of WBTC at the time of the exchange was $70,000. A CGT event happens when the BTC is wrapped through that smart contract. Kal will have a capital gain of $10,000.

This could very well lead to unexpected and potentially absurd results. For example, the unwrapping of a token will also be a CGT event. Continuing the ATO's example of Kal above, if Kal were to use a miniscule portion of the wrapped bitcoin, WBTC, on another blockchain (say 0.0002 WBTC) before unwrapping the remaining WBTC almost immediately, Kal would likely be unwrapping a near equivalent amount of $70,000. Although the capital gain or loss in this instance would be nominal (as Kal's cost base for the WBTC would be similar to the proceeds of the unwrapped BTC given the short time frame), Kal has still incurred a ~$10,000 capital gain on the initial wrapping event simply for converting his existing asset into a software compatible form to perform a single nominal transaction on a different blockchain.

In a more straightforward example, the simple act of wrapping and unwrapping a token, without an actual substantive disposal, can create *huge* inadvertent income tax liabilities for individuals.

This approach is not surprising, and has in fact been the assumed position of the ATO by industry professionals for years.

Conclusion

In the ever evolving landscape of the blockchain ecosystem, it is important that regulatory bodies take into account the unique nature of blockchain and distributed ledger technology when making laws and industry guidance but ultimately until there is legislative clarity regulators can only enforce the laws which are on the books. Individual taxpayers must proceed with caution, noting the significant tax compliance burdens which the ATO is signaling around crypto asset activities.

There remains significant uncertainty in relation to the taxation of crypto assets, and with the Board of Taxation review due in February 2024, taxpayers will have to wait a little longer for better clarity on taxation of crypto-assets.

By Michael Bacina, Steven Pettigrove and Luke Higgins

Hong Kong to tokenise investments

Earlier this month, the Hong Kong Securities and Futures Commission (**SFC**) published two highly-anticipated circulars providing guidance to intermediaries engaging in tokenised securities-related activities (**Tokenised Securities Circular**), and on the tokenisation of SFC-authorised investment products (**Investment Products Circular**) (together, **Circulars**).

These Circulars, along with other initiatives taken by the Hong Kong government (including the new Virtual Asset Trading Platform licensing regime which became effective on 1 June 2023) signifies Hong Kong's efforts to embrace financial innovation using distributed ledger technology (**DLT**) and to foster a responsible regulatory environment for the sector.

The focus on tokenisation corresponds with the growing global interest in tokenising traditional financial instruments and expanding these products to retail. Over the past year, powerful financial institutions such as JP Morgan, Citi and BlackRock have voiced their ambition in this space commencing work on various tokenisation projects.

The key points in these Circulars are below.

See-through Principle

Deviating from its 2019 Statement which regarded all security tokens as "complex products" requiring enhanced investor protections, SFC now explicitly adopts a "see-through" approach to tokenised investment products. SFC said in their Tokenised Securities Circular:

> …the nature of Tokenised Securities are fundamentally traditional securities with a tokenisation wrapper, the existing legal and regulatory requirements governing the traditional securities markets continue to apply to Tokenised Securities.

This reflects a significant change of position for SFC. It means that the distribution and marketing of Tokenised Securities will no longer be strictly limited to professional investors (so called **PI-only** restriction), as required in the 2019 Statement.

SFC instructs intermediaries to adopt the see-through approach and:

> … determine whether a Tokenised Security is complex or not by assessing the underlying traditional security…

However, the offerings of Tokenised Securities to the Hong Kong public will continue to be subject to SFC's public offering regimes, which prescribes prospectus and other documentary and procedural requirements.

SFC has also noted that existing conduct requirements for securities-related activities will apply to the distribution of or advising on Tokenised Securities, management of funds investing in Tokenised Securities and secondary market trading of Tokenised Securities on licensed Virtual Asset Trading Platforms.

SFC's guidance for Tokenised Securities

In the Tokenised Securities Circular, SFC has set out considerations for intermediaries choosing to engage in Tokenised Securities-related activities. Some of them are:

1. Managing new risks: intermediaries should manage new risks created by tokenisation in relation to ownership (e.g. how ownership interests are transferred and recorded) and technology (e.g. forking, network outages and cybersecurity risks, depending on the type of DLT network used);
2. Issuance of Tokenised Securities: where intermediaries issue Tokenised Securities which they also intend to deal in or advise on (e.g. fund managers of tokenised funds), they remain responsible for the overall operation of the tokenisation arrangement, even if they have entered into outsourcing arrangements with third parties.
3. Dealing in, advising on, or managing portfolios investing in Tokenised Securities: intermediaries should conduct due diligence on the issuers and their third party vendors / service providers, as well as the features and risks arising from the tokenisation arrangement. They should be satisfied that adequate controls are in place to *before* engaging in any of these activities; and
4. Disclosure: intermediaries should make adequate disclosures to clients of material information (including risks) specific to Tokenised Securities.

SFC considers that some securities that utilise DLT are not traditional financial instruments "wrapped" in a token – rather, they are complex products called Digital Securities, on the basis that they are likely to be bespoke in nature, terms and feature. Digital Securities should generally not be offered to retail investors.

SFC's guidance for other tokenised investment products

The Investment Products Circular separately sets out SFC's considerations for tokenisation of other investment products (i.e. SFC-authorised investment products) for offering to the Hong Kong public. It is worth noting that SFC requirements for Tokenised Securities will also apply to the tokenisation of SFC-authorised investment products.

Applying the same "see through" approach, SFC will allow *primary* dealing of tokenised SFC-authorised investment products provided that the underlying product meets certain product authorisation requirements, for example:

1. Having in place a sound tokenisation arrangement;
2. Making clear and comprehensive disclosure in offering documents of a tokenised SFC-authorised investment product;
3. Only regulated intermediaries (e.g. licensed corporations or registered institutions) can distribute tokenised SFC-authorised investment products.
4. Staff competence; and
5. Prior consultation with SFC will be required for tokenisation of existing SFC-authorised investments and the introduction of new investment products with tokenisation features.

Meanwhile, driven by investor protection concerns, SFC has adopted a more prudent stance regarding the *secondary* trading of SFC-authorised investment products. SFC believes further consideration is required in order to provide investor protection on a substantially similar level to those provided for non-tokenised products. SFC flagged a few considerations including maintenance of proper and instant token ownership record, readiness of trading infrastructure and market participants to support liquidity, and fair pricing of tokenised products.

What's next?

The Circulars provide welcome guidance to intermediaries in relation to tokenisation of traditional financial instruments. It is clear that SFC will expect intermediaries to closely engage with them prior to embarking on any activities in relation to tokenised products. Apparently undeterred by the recent JPEX scandal, the Hong Kong government is pressing ahead with a regulated approach to protect consumers, foster a better innovation environment for crypto business, and to regain its status as Asia's crypto hub.

By Steven Pettigrove, Michael Bacina and Jake Huang

Party amid a rally? AusCryptoCon 2023

Amid the biggest crypto rally in 2023 which sent the Bitcoin price to a 12-month high, the Australian Crypto Convention was successfully held over the weekend of 11 and 12 November in Melbourne.

With over 10,000 attendees, 250 speakers and 250 sponsors/exhibitors, Aus Crypto Con 2023 created a huge buzz at the Melbourne Convention and Exhibition Centre by the Yarra river.

Presentors included industry heavyweights and prominent professionals, such as:

- Michael Saylor, founder of MicroStrategy who famously bought 17,732 Bitcoins for $175 million
- Justin Sun, founder of Tron
- Ecowyn Chen, CEO of Trust Wallet
- Sergej Kunz, co-founder of the 1Inch network
- Michael Bacina, blockchain lawyer at Piper Alderman and Chairman of Blockchain Australia

The agenda included a jam-packed list of presentations and panel discussions across two days. The following is a brief recap.

Regulation

With an increasingly strong enforcement approach by the Australian Securities and Investments Commission (**ASIC**) and the release of the *Digital Assets Platform* consultation paper by the Treasury, regulation of the industry was at the forefront of many minds and the focus of several presentations.

These include: Binance's investigations team sharing their experience in protecting users' assets and cooperating with law enforcement; Michael Bacina from Blockchain Australia and Mark Monfort from NotCentralised explained Australia's new digital asset regulations in layperson's terms; Aaron Lane from the RMIT Blockchain Innovation Lab also discussed current cases and future trends of Crypto Law.

Bitcoin

As the Bitcoin price reached 12-month highs, it could not have been better timing for Michael Saylor to show his unwavering belief in Bitcoin. Taking the audience on a deep dive into the crypto universe, Michael Saylor emphasised Bitcoin's

> status as the best property in the world and how it has transformed MicroStrategy's approach to investment.

Saylor also offered his views on the highly-anticipated Bitcoin ETF and the challenges to educate the public about cryptocurrency.

The surge in the Bitcoin price also prompted discussions on mining. Will Wright, co-founder of the Mining Store, shared his views on the results of mining Bitcoin since 2014, and the strategies their clients have adopted over the years.

Mainstream adoption

One cannot attend Aus Crypto Con without noticing PayPal (and their booth handing out an unbelievable loot of lollies), whose presence is not at all surprising given PayPal has demonstrated strong interest in crypto including issuing its own USD stablecoin and simplifying crypto purchases. PayPal discussed their continuous commitment to building consumer trust in crypto,

> …at the intersect between 400m consumers and 30m merchants enabling $1.4T in transactions every year… PayPal can meaningfully contribute to the crypto landscape over the coming years.

Tokenisation

Edward Wong, International Strategic Advisor from ASIC and Simon Callaghan, CEO of Blockchain Australia took the audience on a journey from traditional financial systems to a tokenised digital economy. They reflected on the position of the IMF-FSB joint policy roadmap and the IOSCO recommendations, dived into the latest innovation in banking and fintech, and envisioned the expansive future of the digital economy.

Jack Jiang from Wealth Pi and Brooks Huang from Joltify Chain also discussed how tokenisation of real world assets could enhance liquidity, increase accessibility and unlock new investment opportunities.

Web3 development

A dynamic panel which includes Darren Rogan, CEO of Horselink and Harrison Dell of Cadena Legal delved into the world of Web3 gaming and discussed how blockchain technology is reshaping the gambling industry.

Emerging talents from several Australian universities also provided insights on how to educate, engage and empower the student masses within Web3.

Decentralised finance

Justin Sun provided an expert analysis of the exponential growth and increasing adoption of DeFi, highlighting the dramatic rise in the user base and broadening array of services.

Blockchain and AI

You cannot have a successful conference on emerging technologies without mentioning AI a few times. Web3 Educator Danielle Marie presented on the convergence of blockchain and AI in the context of future identify management.

The Conclusion

Compared with last year's Aus Crypto Con, the themes again demonstrated focus on regulation, compliance and exploring the way forward for the industry, probably thanks to the high-profile collapses of several crypto firms. However, one only needed to spend 5 minutes in the room to conclude that the enthusiasm from the attendees and industry participants has not wavered.

By Michael Bacina, Steven Pettigrove and Jake Huang