September 22, 2017

BRIGHT LAW FIRM

JURY.ONLINE

LEGAL OPINION

Table of contents

I. Regulatory environment for JOT cryptographic ICO token sale

In the opinion of the author the answering to the Client's issues raised above presumes first the analysis on what Jury.Online cryptographic token **(JOT)** is. The author explains that if there is no certain opinion about what the token is, it is not possible to answer whether the token is a security, or whether the value-added tax shall be added at its transfer or whether the transferor of token is subject to regulation of the Anti-Money Laundering/KYC regulation etc.
The author of this memorandum has understood the Jury.Online cryptographic token (JOT) as the following:

1. Jury.Online is the provider of blockchain technology based service platform that enables users to make deals which, in case of dissatisfaction of any party, are considered by a panel of jurors delivering judgement in favor of one of the parties.

2. Jury.Online requires financing for bringing its vision and the provided service to the users. For that purpose, Jury.Online has decided to use crowdfunding method through digital token crowdsale, i.e. approach whereby the investment needed for activities is collected as contributions of different investors.

3. JOT is the name of the main currency in the Jury.Online platform and is considered to be the primary mean of payment for Jury.Online platform service and collaterals used on the platform. All primary activities will be based on JOT token.

4. Like another similar cryptocurrency JOT is transferable and fungible. JOT tokens are used for escrow/backing during specific voting processes, collateral for investments and trading.

5. Acquisition of cryptographic tokens from Jury.Online does not present an exchange of cryptocurrencies for any form of ordinary shares in Jury.Online, its platform or the website, and holder of any cryptographic tokens, issued by Jury.Online is not entitled to any guaranteed form of dividend or other revenue right. Holders of JOT are only entitled to the use of platform and its software, to pay with JOT for the services the platform offers and certain other rights within the platform in accordance with the terms that will be set out in Jury.Online JOT token sale terms and conditions.

6. Jury.Online not provider of exchange services between virtual currencies and fiat currencies.

On the basis of the above the author concludes JOT gives its owner the right to access certain parts of the Jury.Online platform and its services. JOT holders don not have any influence in the development or governance of Jury.Online platform and its services, and JOT do not represent or constitute any ownership right or stake, share or security or equivalent rights or any right to receive future revenue shares, or any other form of participation in or relating to Jury.Online as an organization.

NB! At the same time, it cannot be disregarded that according to Jury.Online White Paper draft[1] JOT meets the requirements of ERC-20 compatible Ethereum token and it is designed to be exchangeable on cryptographic token exchanges, i.e. can be bought and sell in the cryptocurrency exchange places. Therefore, JOTs can be regarded as cryptocurrency.

[1] https://docs.google.com/document/d/1Xsa6SEqEp3vZCDFxQaroF1CYS8TaDup2f4RSyjWBprc/edit#

Based on the above the author makes two conclusions proceeding from the above.

1. JOTs signifies the right of its holders to:

a. Participate, have access to certain parts of the Jury.Online platform and its services;
b. JOT holders don not have any influence in the development or governance of Jury.Online platform or its organization,
c. JOT do not represent any ownership right, share or security or any right to receive future revenue shares.

2. JOT is a Ethereum compatible token, i.e. cryptocurrency.

Proceeding from the above two conclusions the author further analyzes what is the legal regulation of JOT.

a) JOT as e-money

In the opinion of the author JOT could be e-money, as it could be tradable.

The issues related to e-money are regulated in the Estonian legislation by the Payment Institutions and E-money Institutions Act (MERAS[2]). § 6 (1) of MERAS specifies the definition of e-money, according to which e-money is monetary value stored on an electronic medium which expresses a monetary claim against the issuer and meets all the following conditions:

1) it is issued at par value of the amount of the monetary payment received;
2) it is used as a payment instrument to execute payment transactions within the meaning of subsection 709 (6) of the Law of Obligations Act;
3) it is accepted as a payment instrument by at least one person who is not the issuer of the same e-money.

In the opinion of the author JOT is not meeting the e-money characteristics due to the following reasons:
- JOT is not expressing a monetary claim, as Ethereum token is decentralized – it has no issuer.
- even if to consider that the issuer of JOT, by considering the circumstances, is Jury.Online, it does not change the above provided conclusion in the final stage, as JOT is not expressing a monetary claim against Jury.Online.

In this context JOT is expressing the right to participate, to access to certain parts of the Jury.Online platform and its services. Although the participation on Jury.Online platform may end up providing the JOT holders with some preferences, it does not mean that JOT holders have a monetary claim against Jury.Online. The latter due to the reason that the possession of JOTs does not represent any ownership right, share or security or any right to receive future revenue shares, or any other form of participation in or relating to Jury.Online. As JOT is not expressing a monetary claim against its issuer, JOT does not qualify as e-money. Hereby the author adds that the European Central Bank is in the opinion that the legal nature of e-money and cryptocurrency is different. In this part, the commission has presented also the table to record the differences between e-money and cryptocurrency[3].

[2] Based on the EU "e-money" Directive

[3] European Central Bank. Virtual Currency schemes, October 2012, p 16, table 2. http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf

b) JOT as the security

According to § 917 (1)1) of the Estonian Law of Obligations Act a security is any instrument to which a patrimonial right is attached in a manner which precludes the exercise of the right without the instrument. According to § 917 (1)2) of the Law of Obligations Act in cases stipulated by law the security is also the rights expressed and given over only by mediation of the registry entry.

According to § 917 (1)1) of the Law of Obligations Act the security should be a document. According to the Estonian legislation the document could occur also in the digital form. As Ethereum compatible token is stored digitally, it could be concluded that JOT is a digital document.

The security could though be a document related to any proprietary right. In the opinion of the author no proprietary right is connected with JOT token, as JOT owner could not require the sale, purchase or exchange of JOT from anyone. The latter differently from e.g. bond the owner of which has the claim against the issuer of bond or goods security, the owner of which has the claim against the receiver of the goods. As JOT is not a right, this could not be a security also in the meaning of § 917 (1)2) of the Law of Obligations Act.

As JOT is not a proprietary right or right, JOT is not a security in the opinion of the author for the purpose of § 917 of the Law of Obligations Act.
The issues related to the securities are also regulated by the Estonian Securities Market Act **(VPTS).** § 2 (1) of VPTS opens the definition of security,

according to which the security is a proprietary right or obligation or contract given over based on at least unilateral expression of will:

1) share or any similar tradable right;
2) bond, exchange security or other issued and tradable debt obligation which is not a money market instrument;
3) subscription right or any other tradable right giving a right to acquire the securities mentioned in clauses 1 or 2 of this section;
4) share of an investment fund;
5) money market instrument;
6) derivative instrument or derivative contract;
7) depository receipt of marketable security.

In the opinion of the author JOT is neither a proprietary right, obligation nor also a contract. As previously provided, JOT gives its owner the right to have access to certain parts of the Jury.Online platform and its services. JOT holders do not have a proprietary right or a claim against Jury.Online. The latter due to the reason that the possession of JOTs does not represent any ownership right, share or security or any right to receive future revenue shares, or any other form of participation in or relating to Jury.Online platform or its organization, hence no reasonable expectation of any profit. Therefore, the author does not think that JOT should be qualified as a security.

In addition to the definition of the security the Securities Market Act also stipulates what is not a security in for the purposes of the Act. Thus § 2 (8) of VPTS stipulates that securities are neither bills of exchange, cheques nor other payment means, excluding the bill of exchange guaranteed by credit institution handled as the money market instrument. Thus, the author analyzes as follows whether JOT could

be a bill of exchange, cheque or means of payment.

c) JOT as the bill of exchange

§ 925 (1) of the Estonian Law of Obligations Act stipulates that a draft is an order security by which the drawer orders the mandatary (the drawee) to pay a determinate sum of money to the person entitled on the basis of and specified in the draft at the maturity specified in the draft (payment of draft). The order shall be unconditional. It is clear on the basis of the above provided regulation that JOT could not be a draft.

According to § 926 of the Law of Obligations Act a promissory note is an order security by which the drawer of the promissory note unconditionally undertakes to pay the amount of the promissory note to the person entitled on the basis of and specified in the note at the maturity specified in the note. As Jury.Online does not undertake unconditionally to pay to JOT owner, JOT could not be handled as promissory note.

d) JOT as the cheque

§ 979 (1) of the Law of Obligations Act stipulates that cheque is a security with which the drawer of the cheque orders a credit institution (the drawee of the cheque) to pay a specific sum of money (the amount of the cheque) to the person entitled on the basis of the cheque (the payee). The order shall be unconditional. In the opinion of the author it is obvious that JOT is not a cheque.

e) JOT as the means of payment

The author finds that as if JOT is a cryptocurrency which might be later purchased, sold and exchanged, it could be handled as means of payment.

The Estonian legal acts include no definition of means of payment. The author finds that the means that can be redeemed for other goods and services can be handled as the means of payment. Thus, the means of payment is a synonym of cash.

The Estonian legislation does not include the legal definition of means of payment such as cash, currency or virtual currency. This means that these are undefined legal terms. The earlier valid currency act also did not specify the general definition of money, but § 3 of the relevant act fixed Estonian kroon as the only legal means of payment of the Republic of Estonia and specified that the legal and physical persons located in the Republic of Estonia have no right to use other means of payment in mutual settlements.

By considering the Estonian legal system the author finds that the definition of money should proceed from the Estonian Law of Obligations Act. Mainly due to the reason that the provisions of law are applied to the contracts, mutual transactions and also debt relations. Inter alia, the definitions of a security and bill of exchange are also defined. The definition of money should, inter alia, define with which the debtor can fulfil the monetary obligation.

Hereby it is essential to point out that Law of Obligations Act does not stipulate that the monetary obligation could be fulfilled only with national currencies of member states of UN, WTO, OECD, thus the agreements of the parties as to the method of fulfilment of the monetary obligation are not excluded. Namely, according to § 76 (1) of the Law of Obligations Act the obligation should be fulfilled

according to the contract or law. § 91 (1) of the Law of Obligations Act specifies that a monetary obligation may be performed in cash. A monetary obligation may also be performed in some other form if so agreed by the parties or if such form is used in the ordinary course of business at the place of payment.

In addition, the author hereby points out § 709 of the Law of Obligations Act which defines the payment service contract and the related definitions. The section 8 of the given paragraph stipulates the definition of the general means of payment according to which the means of payment, payment instrument or method of payment within the meaning of this Act denote any personalized device or set of procedures agreed on between the payment service provider and its client, which are used by the client of the payment service provider for the initiation of a payment order. As a result, the means of payment could be any other valid means of payment, besides legal means of payment, accepted by the provider of payment service. Today the definition resulting from § 709 of the Law of Obligations Act is though valid only in the meaning of the payment service contract and is not expanding to all means of payment or payment obligations, but the author finds that such wording of the act refers to the will of legislator to enable the parties of the contract to choose their means of payment, regardless of its legal status.

The similar practice is also supported by the European Commission by stipulating that the creditor could not refuse e.g. from the receipt of euro banknotes and coins, unless the parties have previously agreed to use other means of payment[4].

The above provided provision stipulates that the contract parties have the right to agree which means of payment they accept in fulfilment of the monetary obligation. Thus, the payment could be also made e.g. in cryptocurrency in addition to so-called official currency. Due to the latter JOT might be qualified as the contractual means of payment.

As JOT is a means of payment, thus JOT could not be a security only due to the above provided reason (§ 2 (8) of VPTS).

To sum up, the author concluded in this subtopic that JOT can be handled as means of payment in legal meaning.

[4] Recommendation of the European Commission, 22 March 2010, 2010/191/EU on the scope and effects of legal tender of euro banknotes and coins; recommendation cl 1a http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32010H0191&from=ET

II. Regulatory environment for crowdfunding

First, it must be determined which Estonian legal acts govern this field and particularly the financing of legal entities through crowdfunding.

The Estonian law has not yet been updated in relation to crowdfunding5. The proposal for a corresponding act has been presented, but for the time being we can manage without this. As such, Estonian law provides no answers to the questions of what is crowdfunding and how it should be legally approached. Therefore, there is no difference between crypto or fiat crowdfunding in this sense. Nevertheless, issues related to crowdfunding have been examined several times by the European Commission.

At the outset, in its memo of 27 March 2014 the European Commission explained that crowdfunding is „an emerging alternative form of financing that connects directly those who can give, lend or invest money with those who need financing for a specific project"[1]. Next, the Commission has presented the following main types of crowdfunding in its guide:

- **peer-to-peer lending,** which means that the crowd lends money to a company with the understanding that the money will be repaid with interest. It is very similar to traditional borrowing from a bank, except that you borrow from lots of investors;

- **equity crowdfunding,** which means that a stake in a business is sold to a number of investors in return for investment. The idea is similar to how common stock is bought or sold on a stock exchange, or to a venture capital;

- **rewards-based crowdfunding,** which means that individuals donate to a project or business with expectations of receiving in return a non-financial reward, such as goods or services, at a later stage in exchange of their contribution;

- **donation-based crowdfunding,** which means that individuals donate small amounts to meet the larger funding aim of a specific charitable project while receiving no financial or material return;

- **profit-sharing / revenue-sharing,** which requires that businesses can share future profits or revenues with the crowd in return for funding now. Therefore, crowdfunders have the opportunity to receive a part of future profits made by the project that is being financed, provided that this turns out to be successful and generates profits[2];

- **debt-securities crowdfunding,** where individuals invest in a debt security issued by the company, such as a bond[3].

The Commission has specified that profit-sharing schemes would promise a part of future profits made by the

[1] European Commission. Brussels, 27.03.2014 Memo, available at http://europa.eu/rapid/press-release_MEMO-14-240_en.htm

[2] European Commission. Brussels, 27.03.2014 COM(2014) 172 *final*. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS. Unleashing the potential of Crowdfunding in the European Union. Available at: http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf

[3] European Commission. „Crowdfunding explained – A guide for small and medium enterprises on crowdfunding and how to use it"

project that is being financed. Securities-based crowdfunding involves issuing equity or debt to contributors. The difference from an IPO[4] for example is that the shares issued are typically not traded on a secondary market and there is no underwriting involved[5]. The author of this memo must acknowledge that in our communications with the Estonian Financial Supervision Authority, the latter admitted that they might view the tradability of tokens as one of the signs possibly pointing at a token as a security, but that is to be decided by analyzing all aspects of crowdfunding and token issue terms and conditions.

According to the explanation of the **Estonian Financial Supervision Authority** (which is likely based on the guide by the European Commission), the crowdfunding models offering financial revenue are generally divided into two categories:

(i) loan-based crowdfunding, where the person applying for the funding seeks financial resources from the wider public through a crowdfunding company in order to fund a project under a loan agreement with the promise of returning the loan with or without interest by the due date; and
(ii) investment- or stake-based crowdfunding, where the person applying for the funding offers an opportunity to invest in the securities, shares, stakes or equity instruments of their company through IPO and, in return, receive a stake, security or part of the project revenue.

It appears that, in its explanation, the Estonian Financial Supervision Authority itself distinguishes between the types of crowdfunding, where in the first case, the investor receives a bond in return for their funding, and in the second case, a part of the project revenue.

In its explanation the Estonian Financial Supervision Authority also notes that *„crowdfunders are required to assess whether their activities may include features that require the application for or registration of an activity license in accordance with the terms and conditions and pursuant to the procedure provided by the acts specified in subsection 2 (1) of the Financial Supervision Authority Act, or whether, on the basis of the circumstances of the offer made as part of the project mediated by them, the offer and the securities offered in the project qualify as securities within the meaning of the Securities Market Act, according to which a public issuing must be registered."* Subsection 2 (2) of the Financial Supervision Authority Act stipulates that, within the meaning of this act, a subject of a financial supervision is a person to whom the right to operate in the corresponding field of activity has been granted by a competent authority on the basis of an Act specified in subsection (1) of this section.

[4] i.e. the type of crowdfunding entailing profit- and revenue-sharing
[5] European Commission. Brussels, 27.03.2014 COM(2014) 172 *final*. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS. Unleashing the potential of Crowdfunding in the European Union. Available at: http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf; and European Commission. Brussels, 27.03.2014 memo, available at: http://europa.eu/rapid/press-release_MEMO-14-240_en.htm.

III. JOT & value-added tax

a) JOT as money in the meaning of VAT Directive, article 135 (1)e)

By imposing the value–added tax on JOT as the cryptocurrency the question whether JOT or its transfer is the object of value-added tax should be first answered. The answer depends on whether JOT can be regarded as money (i.e. currency used as legal means of payment) in the meaning of the basic act of value-added tax of the European Union, i.e. VAT Directive, article 135 (1)e) or as other negotiable means of payment in the meaning of VAT Directive, article 135 (1)d)[5].

According to the generally accepted principles the transfer of money does not involve the consequences of value-added tax, as the goods supply and provision of services, not the fee payable for these, are taxed with value-added tax.

This means that money and the transfer of its similar rights is not the object of the value-added tax.[6] The same is confirmed by the basic principle of value-added tax, according to which value-added tax is a consumption tax – by this consumption is taxed. As money is the means of payment, this cannot be consumed in the classical meaning[7].
According to article 135 (1)e) of the VAT Directive the member states exempt the transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest from the VAT.

To specify whether the VAT exemption is applied as to the transfer of JOT based on article 135 (1) e), it is essential to first analyze whether JOT could be regarded as money according to the mentioned article?

JOT as the cryptocurrency functions as money. Also, the author has reached a conclusion in the course of earlier analysis that JOT is a contractual means of payment. In the context of value-added tax it is necessary to additionally analyze whether cryptocurrency can be regarded as cash in the legal meaning?

The Estonian legal literature has found that cash is the means of payment established and recognized by the state. Three main functions of money are the function of means of exchange and payment, function of preservation of value and function of benchmark of value of goods and services.
The European Central Bank has found that money has three functions: money is 1) means of payment; 2) unit of account and 3) store of value.[8] The author finds that although JOT is the means of payment and unit of account, it could not be stated that JOT is the store of value. The latter foremost due to the reason that there is no supervision over cryptocurrency,

[5] Council Directive 2006/112/EC, 28 November 2006, handling common value-added tax system http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32006L0112&from=EN
[6] Proposal of the advocate general of the European Court of Justice of 24 October 2013 in court case C-461/12 (Granton Advertising BV), p 41. http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62012CC0461&qid=1500035799169&from
[7] Redmar Wolf. Bitcoin and EU VAT. International VAT Monitor, 2014 (volume 25), No. 5. 05.09.2014, lk 255. http://www.belastingrechtaandevu.nl/Portals/0/images/Wolf_artikel8.pdf
[8] European Central Bank. Virtual Currency schemes, February 2015, p 23. https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf

potential technical problems are existing and which is probably most important, there is no stability. Even if to regard cryptocurrency as money, it would be complicated to classify the transactions to be made with cryptocurrency under VAT directive article 135 (1)e) due to the reason that this presumes the use as legal means of payment – the criterion not met in case of cryptocurrency.

Considering the above, the author concludes that cryptocurrency is still means of payment, but not legal means of payment. Cryptocurrency should be differentiated from legal currency which is official means of payment of the relevant country in the face of the coin or banknote, is in circulation and which is in general used and accepted as the means of payment in the country issued by this country. Proceeding from the fact that the cryptocurrency is not handled as legal means of payment, the tax exemption should not be applied to cryptocurrency in grammatical interpretation of VAT Directive article 135 (1)e).

At the same time, the author found in the course of analysis that the European Court discussed the case where the court analyzed whether the VAT exemption is applied to bitcoin as the cryptocurrency. The advocate general of the European Court found in this court case that it is **extremely important to regard the rights which are considered similar to money as the assignment of money itself in VAT meaning** and the assignment of money as such as generally accepted is still not taxed and only this is taxed which is regarded as fee for transaction, i.e. in other words no turnover incurs in transfer of the money or other negotiable means of payment in the meaning of VAT directive.[9]

The author explains that cryptocurrency is regularly referred to as digital currency which indicates that this role is equal to traditional money from the viewpoint of the users. The aim of cryptocurrency is to replace the legal means of payment and be generally acceptable similarly to money, by giving anonymity as added value and possibility to forward means by not using the third parties.

Thus, proceeding from the fact that cryptocurrency is the right similar to money and the opinion of advocate general of the European Court of Justice according to which the assignment of the rights similar to money should be regarded as the assignment of money itself, it can be concluded that VAT exemption is applied to cryptocurrency, as money is not an object of VAT.

Furthermore, the European Court of Justice reached an opinion in the same court case that *bitcoin* is a virtual currency. Namely, the European Court of Justice pointed out that the virtual currency *bitcoin* is a contractual means of payment, by constituting the immediate payment method between these transaction parties who accept this. The court considered it necessary to also refer to the report of 2012 handling the virtual currency of the European Central Bank, according to which *bitcoin* belongs to the system of virtual currencies with bidirectional flow, in case of which the users can buy and sell the virtual currency based on

[9] Proposal of the advocate general of the European Court of Justice of 24 October 2013 in court case C-461/12 (Granton Advertising BV), p 41. http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62012CC0461&qid=1500035799169&from

the exchange rate of currency. The functioning of such virtual currency in real world is similar to other convertible currencies, as it enables to buy real as well as virtual goods and services.

Based on the above the European Court of Justice found that the virtual currency bitcoin with so-called bidirectional flow which is exchanged in the course of exchange transaction for currency could not be regarded as "tangible assets"in the meaning of VAT Directive, article 14, as the virtual currency has no other meaning than to be usable as (contractual) means of payment. Thus, the transfer of bitcoin is not the object of VAT and this does not involve the VAT liability.

The author explains that as JOT is cryptocurrency as bitcoin, ETH, JOT is also virtual currency. According to VAT Directive article 135 (1)e) the VAT exemption is also applied to currency. **The author is in the opinion that JOT is not thus the object of VAT also as this is currency to which the VAT exemption is applied according to article 135 (1)e) of the VAT Directive.**

In addition, the author points out that the above provided court settlement of the European Court of Justice confirms the conclusion of the author on that cryptocurrency is the means of payment.

b) JOT as the other negotiable means of payment

The above chapters enable, inter alia, to conclude that JOT is a decentralized digital currency that can be used as contractual means of payment in purchase of goods and services, if the merchant accepts it.

The author analyzes below whether cryptocurrency can be regarded as other negotiable means of payment. Such interpretation provides a basis for VAT exemption based on the Directive article 135 (1)d) which stipulates the tax exemption for the transactions related to deposits and bank accounts, payments, transfers, debt claims, cheques and other negotiable means of payment, including the related negotiations. Considering that the definition of other negotiable means of payment has not been explicitly established in the VAT directive, the author analyzes the practice of the European Court of Justice as follows to open up the content of the concept.

It could be concluded from the case of the European Court of Justice of Granton Advertising that the concept of other means of payment in the meaning of article 135 (1)d) is closely connected with the nature of payment instruments which function as cash transfers.[10] Related to the given case the advocate general gave an assessment according to which the samples mentioned in article 135 (1)d) give the right to certain cash amount. Thus, it is understandable, if other negotiable means of payment mean only these rights which – without being debts or cheques – give the right to certain cash amount. If the unofficial currency used as alternative means of payment is transferrable and this could be sold with certain price, the VAT exemption is not applied to it in case the cash transfer is not involved with its transfer which is involved in all tax exemptions listed in the provision.

[10] EKo 12.06.2014, C-461/12, Granton Advertising BV vs Inspecteur van de Belastingdienst Haaglanden/kantoor Den Haag. http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62012CJ0461&from=EN

In case of cryptocurrency the certain question still remains related to their negotiability. Cryptocurrency can be exchanged for regular currency, but still only to the scope that the other party agrees to buy. The users who buy Ethereums can sell these only if the other party wishes to buy their Ethereums.

The aim of cryptocurrency is to create alternative means for preservation of value which can be used for the purchase of goods and services. As by assets in general, JOT as Ethereum compatible token might have financial value, but differently from the financial instruments mentioned in article 135 (1)d) its value depends on the market price without JOT giving additional rights to other assets and the person is not protected at its realization.

The fact that thanks to its decentralization JOT is not related to official currency and its value might vary depending on the quantity and demand of existing JOT, this does not nullify the existence of financial value. It is not required that the means of payment should have fixed rate as to some official currency. The purchaser and seller of JOT could in principle agree in any price with each other and these can be transferred if the other party wishes it in its turn. Regardless of that no right of claim was given to the fixed cash amount and this is not issued in the nominal value of amount received for monetary contribution, JOT still has financial value.

Due to the above the question arises whether VAT exemption applies to cryptocurrency regardless of that cryptocurrency is not negotiable without limits. In the opinion of the author this question can be answered affirmatively due to two reasons.

Firstly, cryptocurrency has financial value regardless of having certain limits while trading with it.

Secondly, this can be concluded through the interpretation of the aim of tax exemption. Considering the general interpretation of tax exemptions, the European Court of Justice has stated that the terms used for specification of tax exemptions should be interpreted strictly, considering that tax exemptions are exceptions from the general principles, according to which each service provided by the tax liable person for fee is taxed with value-added tax.

In any case the interpretation of terms should be in accordance with the aims of the mentioned tax exemptions and withhold from the requirements of neutral taxation principle which is an integral part of the common VAT system. At the same time, it must be remembered that the requirement of strict interpretation does not mean that the terms specifying the tax exemptions listed in the mentioned article should be interpreted so that it takes the impact from tax exemptions and should be thus compliant with the objective of tax exemption. Also, it should be considered that the specification of the scope of tax exemption should not proceed only from the text-based interpretation. In addition, the provision of the law of the European Union should be interpreted proceeding from the context and the aims applied for with this legal act including the provision. The aims of the tax exemption provision of financial services are to exceed the difficulties related to the specification of the taxable amount and the amount of deductible value-added tax. The European Court of Justice has also

found that the common VAT system is based on the neutral taxation principle, thus it is forbidden to handle the entrepreneurs making similar transactions in taxation with VAT differently.
Thus, the tax exemption regards the transactions characteristic of the activities provided in the wording of the directive.

As JOT:
a) might function as cash transfer
b) might have financial value and
c) might be tradable.

It can be stated that JOT as the transactions related to cryptocurrency are handled with the transactions related to negotiable means of payment in the context of VAT Directive article 135 81)d), as a result the VAT exemption is applied to them.

IV. Taxation of ICO proceeds

Estonian taxpayers are resident and non-resident legal entities and individuals. The term legal entity includes companies, partnerships, legal entities established under public law and non-profit organizations and foundations. A legal entity is treated as resident in Estonia if it is founded under Estonian laws. An Estonian branch of a foreign company is generally treated as a permanent establishment of a non-resident entity.

Taxpayers that are based in Estonia and are registered in the Estonian Commercial Register (subsidiaries, branches etc.) will be automatically recorded into the taxpayers registry that is held by Estonian Tax and Customs Authorities. A separate registration is required for VAT purposes. Foreign companies can only register with the Tax and Customs Authorities in certain circumstances (e.g. acting as a foreign employer, having a permanent establishment and as a VAT liable person).

Direct taxation in Estonia takes the form of corporate and individual income taxes, as well as a gambling tax. Indirect taxes include VAT, excise taxes and customs duty.

All undistributed profits are tax-exempt. This exemption covers both active (e.g. trading) and passive (e.g. dividends, interest, royalties) types of income, as well as capital gains from sales of all types of assets, including shares, securities and immovable property. This tax regime is available to Estonian legal entities and permanent establishments of foreign companies that are registered in Estonia. Profits are not taxed until the profits are distributed as dividends, share buy-backs, capital reductions, liquidation proceeds or deemed profit distributions, such as transfer pricing adjustments, expenses and payments that do not have a business purpose, fringe benefits, gifts, donations and business entertainment expenses.

Therefore, it can be stated that if the proceeds from the ICO are to be considered as profit, then they are tax-exempt until distribution.

V. JOT & AML/KYC (anti-money laundering regulation)

According to § 47 (1) of the Money Laundering and Terrorist Financing Prevention Act **(RahaPTS)** the Financial Intelligence Unit in Estonia (RAB) exercises supervision over the activities of the obligated persons. Thus, one should specify whether the requirements resulting from the Money Laundering Act are applied to the organizer of ICO crowdfunding issuing JOT to an investor or not.

In general, the subjects of the act are two risk groups:
1) the persons the risks of whose activities proceed from the nature of their economic, vocational or professional activities;
2) the persons the risks of whose activities proceed from making or exchanging the large-scale cash transactions.

According to § 3 (1) of the Money Laundering and Terrorist Financing Prevention Act the obligated persons are the following persons:

1) credit institutions;
2) financial institutions;
3) organizers of games of chance;
4) persons who carry out or act as intermediaries in transactions with real property;
5) traders for the purposes of the Trading Act;
6) pawnbrokers;
6[1]) persons engaged in the buying-in or wholesale of precious metals, precious metal articles or precious stones, except precious metals and precious metal articles used for production, scientific or medical purposes;
7) auditors and providers of accounting services;
8) providers of accounting or tax advice services;
9) providers of trust and company services;
10) non-profit associations and foundations if a cash payment of more than 15 000 euros or an equal amount in another currency is made to them.

As to the options above, the legal person issuing JOTs can be handled as the credit institution (RahaPTS § 3 (1)1)) or financial institution (RahaPTS § 3 (1)2)), as other options[11] stipulated in the act are clearly excluded and require thus no further analysis.

a) Credit institution

Credit institution is a company which main and permanent economic activity is to receive financial deposits and other repayable means from the public and grant loans on its account and name of finance in some other way. The main activity of the credit institution is to provide financial services mentioned in the Estonian Credit Institutions Act **(KAS).** According to § 6 of KAS the financial services are for example loan transactions, leasing transactions, payment services, depositing and management of securities. Resulting from the above, in the opinion of the author it is clear that the legal person issuing cryptocurrency is not a credit institution. The legal person established for the purpose of organizing ICO crowdfunding involves capital from the investors and is not providing financial services. Also, JOT issued within the frames of crowdfunding project is not a financial service in the meaning of the Credit Institutions Act.

[11] A non-profit association is a subject of AML law only in case of cash payments more than 15 000 euros or equivalent. AN' terms stipulate that contribution for ANT can be only done in Digital Assets, i.e. in Ether.

Thus, the legal person issuing JOTs is not a credit institution.

b) Financial institution

In case of the second option the legal person issuing cryptocurrency might be a financial institution. According to § 6 (2) of RahaPTS the financial institution for the purposes of RahaPTS is:

1) a provider of currency exchange services;
2) a payment service provider within the meaning of the Payment Institutions and Electronic Money Institutions Act;
3) an electronic money institution within the meaning of the Payment Institutions and Electronic Money Institutions Act;
4) a provider of services of alternative means of payment;
5) an insurer engaged in life insurance;
6) an insurance broker engaged in mediation of life insurance;
7) a management company and an investment fund established as a public limited company;
8) an investment firm;
9) a savings and loan association;
10) another financial institution within the meaning of the Credit Institutions Act;

As regards the options above in the opinion of the author it is worth controlling whether the legal person issuing cryptocurrency could be the provider of payment service, e-money institution or the provider of service of alternative means of payment. Other options provided in § 6 (2) of RahaPTS are excluded and require no further analysis according to the author.

c) Provider of payment service

According to § 5 (1) of the Estonian Payment Institutions and E-money Institutions Act (MERAS) a payment institution is a company the permanent activity of which is the provision of payment services. According to § 3 (1) of MERAS payment services are the following services provided by a person for the purposes of economic or professional activities:

1) services which enable to make cash payments to payment accounts;
2) services which enable to withdraw cash from payment accounts;
3) execution of payment transactions, including transfer of funds to a payment account opened with a payment service provider;
4) execution of payment transactions if the funds have been granted as a loan to the client of the payment institution;
5) issue and acquisition of payment means, means of payment or payment instruments (hereinafter all jointly *payment instrument*);
6) money remittance;
7) execution of payment transactions

The author finds that the organizer of ICO crowdfunding is not a provider of the payment service, as crowdfunding is organized to involve capital, not to provide payment services. Also, the organizer of crowdfunding is not providing any service mentioned in § 3 (1) of MERAS.

Thus, the organizer of crowdfunding is not a provider of payment service.

d) E-money institution

According to § 7 (1) of MERAS an e-money institution is a public or private limited company the permanent activity of which is the issue of e-money in its name. The author has concluded in the course of previous analysis that cryptocurrency is not e-money. Thus, the organizer of crowdfunding issuing cryptocurrency is not an e-money institution.

e) Provider of service of alternative means of payment

§ 6 (4) of RahaPTS stipulates that a provider of services of alternative means of payment is a person who in its economic or professional activities and through communications, transfer or clearing system buys, sells or mediates funds of monetary value by which financial obligations can be performed or which can be exchanged for an official currency, but who is not a person specified in subsection (1) or a financial institution for the purposes of the Credit Institutions Act.

The author has earlier found that JOT is the means of payment as cryptocurrency and pointed out that the European Court of Justice has handled cryptocurrency as the alternative means of payment. Regardless of the latter, the activities of the organizer of crowdfunding are not meeting the regulation of RahaPTS as the provider of service of alternative means of payment and this due to the following reasons.

1. The economic activities of the organizer of crowdfunding are not directed to the provision of alternative service of means of payment (cryptocurrency), but involvement of capital.

2. The organizer of crowdfunding is neither buying, selling nor exchanging cryptocurrency. The organizer of crowdfunding issues cryptocurrency to the investor for the investment received from the latter. Thus, the organizer of crowdfunding is not buying or selling investor's money, and also it is not acting as the broker (such as currency exchange). The involvement of capital form the investor is a single transaction, not the provision of service related to cryptocurrency.

In Estonia, the Supreme Court has discussed only one case related to cryptocurrency[12]. The Supreme Court held in the latter case that the trading with *bitcoins* as economic activity meets the definition of provision of service of alternative means of payment as stipulated in § 6 (4) of RahaPTS. At the same time, this was the case where the person bought and sold bitcoins, i.e. acted as the broker of cryptocurrency. Considering that the economic activity of organizer of crowdfunding is not the broking of cryptocurrency and there is no such broking in the opinion of the author, the opinions of the referred settlement of the Supreme Court could not be transferred to the activities of the Client.

Based on the above, the author concludes that although cryptocurrency is an alternative means of payment, the issue of JOTs to the investor is not handled as its purchase, sale or mediation. Thus, in the opinion of the author the organizer of crowdfunding is not a provider of alternative means of payment for the purposes of RahaPTS.

[12] RKHKo nr 3-3-1-75-15.

VI. JOT & bank deposit

The client would like to know whether the receipt of digital assets (and in particular the cryptocurrency named Ether) from the investors could be handled as the receipt of deposit.

The definition of deposit has been specified in the Estonian Guarantee Fund Act (TFS). According to § 24 (1) of the latter act, for the purposes of this Act, a deposit shall mean a valid claim for a specified or unspecified term of a deposit against a credit institution arising from the contract between the deposit and the credit institution. A credit institution shall record the monetary value of the claim in an account kept for the execution of payment transactions or in an account kept for depositing the clients' funds. A credit institution shall repay the principal amount of the claim to a depositor pursuant to the legislation or terms and conditions of the contract.

According to the above definition the depositor will have the claim against the receiver of deposit. JOT owner will have no right of claim against its issuer.

Secondly, the definition of deposit indicates that the aim of deposit is the depositing of money, thereby money remains for the depositor. The aim of issue of JOT is not the depositing of investor's money, but involvement of capital. Also, the investor's money is transferred to the ownership of the company.

Thirdly, the definition of deposit is related in the Estonian legislation only with credit institution. According to § 24 (1) of TFS the legal relationship of money depositing could incur only with credit institution. This conclusion is also supported by § 4 (1) of KAS according to which the credit institutions have the exclusive right to receive money from the public for the purposes of depositing or to receive repayable funds in any other manner.

As the author has found in the course of early analysis that the organizer of ICO crowdfunding is not a credit institution, the organizer of ICO crowdfunding could not receive deposits. Also, the receipt of investment is not a deposit.

VII. Accounting for ICO proceeds (fiat/crypto) & audit obligation

The author of this memo has to admit that since the digital currencies is a relatively new matter, most bookkeepers and auditors are still not familiar with how to properly account for these digital assets and transactions with them. Therefore, it represents a certain challenge to find a well-informed specialist.

We know that generally, Bitcoin has been treated by the authorities around the world as a currency. This could make the accounting treatment similar to any foreign exchange company (buying and selling of currencies). The spread on which defines profit/loss that gets captured in the income statement. However, the volume of transactions and the fractions in which Bitcoin and other digital currencies are traded creates a challenging job for accountants.

We might assume that cryptocurrencies could be treated in accountancy on the same principles.

Audit obligation

The financial statements should be audited for all public limited companies (AS) and foundations. For other legal entities audit requirements are below.

(1) An audit of the annual accounts is compulsory for accounting entities within the meaning of the Estonian Accounting Act, in whose annual accounts at least two of the indicators of the financial year exceed the following conditions:
1) sales revenue or income 4,000,000 euros;
2) total assets as of the balance sheet date 2,000,000 euros;
3) average number of employees 60 people.

(2) An audit of the annual accounts is compulsory for accounting entities within the meaning of the Estonian Accounting Act, in whose annual accounts at least one of the indicators of the financial year exceeds the following conditions:
1) sales revenue or income 12,000,000 euros;
2) total assets as of the balance sheet date 6,000,000 euros;
3) average number of employees 180 people.

Review (by an auditor) obligation

(1) A review of the annual accounts is compulsory within the meaning of the Estonian Accounting Act for an accounting entity, in whose annual accounts at least two of the indicators of the financial year exceed the following conditions:
1) sales revenue or income 1,600,000 euros;
2) total assets as of the balance sheet date 800,000 euros;
3) average number of employees 24 people.

(2) A review of the annual report is compulsory within the meaning of the Estonian Accounting Act for an accounting entity, in whose annual accounts at least one of the indicators of the financial year exceeds the following conditions:
1) sales revenue or income 4,800,000 euros;
2) total assets as of the balance sheet date 2,400,000 euros.
3) average number of employees 72 people.

VIII. Summary

The author has analyzed what is the legal nature of JOT and concluded that as JOT is cryptocurrency, this is the means of payment. Related to the latter it is most important to point out that JOT is not a security, meaning that the issue of JOTs to the investor by ICO procedure is not a public offer of securities in the opinion of the author. Thus, the issue of JOTs is not subject to regulation of securities market and the company should not proceed from the requirements of public offer of securities in conducting ICO.

Secondly, we have explained that there is no regulation in relation to crowdfunding in the Estonian law.
Thirdly, the author concluded that JOT is not an object of VAT and this due to three reasons.

1. JOT as cryptocurrency is a money-like right. The money-like right is though handled as money in the context of value-added tax and the transfer of money is not taxable with VAT.

2. JOT is a virtual currency, as to which VAT exemption based on the VAT Directive, article 135 (1)e) is applied.

3. JOT is interpreted as negotiable means of payment, as to which VAT exemption based on the VAT Directive, article 135 (1)d) is applied.

Fourthly, the author found that the requirements arising from AML regulation (RahaPTS) are not expanding to the organizer of ICO crowdfunding, as the organizer of ICO crowdfunding is not an obligated subject in the meaning of § 3 of RahaPTS.

Fifthly, the author concluded that the receipt of investments pursuant to crowdfunding procedure is not regarded as the receipt of deposit.

Finally, the author draws the attention that many known digital currencies have been treated by the authorities around the world as a currency. This could the accounting treatment similar to any foreign exchange company.

The financial statements of a legal entity shall be audited even in case of fulfillment of only one indicator - i.e. the total assets as of the balance sheet date at least 6,000,000 euros.

Sincerely,

Andrei Veressov
attorney at law, founding partner