Blockchain – the future

2017 has seen the continued rise of Distributed Ledger Technology (DLT), often known as Blockchain, which has been at the forefront of debate amongst regulators and Government officials. Blockchain is also attracting enormous attention from our clients at PwC and the wider market. It is complex technology that has the potential to powerfully influence many aspects of how businesses and economies work; even how societies are organised. PwC views Blockchain as potentially the most transformative technology innovation since the coming of the internet. There is, however, a long way to go to realise such ambitions – it remains a nascent technology.

Blockchain is technology which allows for a decentralised ledger that is updated and maintained by various participants, the ledger is not controlled by a central authority, rather by the consensus of the majority of the participants. Blockchain is distinct from Bitcoin, which is merely one application of the technology. Bitcoin has been a proving ground for the underlying Blockchain technology. In a "trust-less" environment since 2008, Bitcoin is continuing to prove Blockchain to be secure and resilient.

On 12 October 2017, the Government of Gibraltar released the draft regulations "Financial Services (Distributed Ledger Technology Providers) Regulations 2017" which set out the regulations of Blockchain businesses in Gibraltar. These regulations will come into operation on 1 January 2018 with initial applications already permitted by the Gibraltar Financial Services Commission and the focus is on nine core principles which each licensee must adhere to.

As Blockchain technology becomes more prominent, it is increasingly likely that entities will hold cryptocurrencies as an investment and/or a transferrable currency and even issue virtual tokens in return for funding for projects.

Cryptocurrencies

A cryptocurrency is a medium of exchange, such as the British Pound, but is digital and uses encryption techniques to control the creation of monetary units and to verify the transfer of funds.

Bitcoin is the most well known example of a cryptocurrency, Blockchain itself was invented in order to create Bitcoin.

Investors speculating in the future possibilities of this new technology have driven most of the current market capitalisation and this is likely to remain the case until a certain measure of price stability and market acceptance is achieved. Apart from the declared price of cryptocurrency, those invested in it appear to be relying on a perceived "inherent value" of cryptocurrency. This includes the technology and network itself, the integrity of the cryptographic code, and the decentralised network.

As cryptocurrencies become more widely adopted we will see more entities holding this in their businesses.

Virtual token sales

One of the major innovations of Blockchain technology is that the technology allows market participants to transfer assets across the internet without the need for a centralised third party.

This has allowed start-up companies to use Blockchain technology to raise funds by allowing potential users and customers to purchase crypto-tokens which can be used in exchange for their products or services. In an initial coin offering ("ICO") or token sale, virtual tokens are usually issued instead of equity shares or loans, this allows companies to raise funds rapidly from multiple users, usually in the form of cryptocurrencies. These virtual tokens can have a variety of properties which range from participation in future profits, access to a platform in development or even a currency which could be spent on the platform in the future. These tokens are usually interchangeable and can be listed on a secondary market.

Token sales are currently unregulated and investors should exercise caution and know the risks involved. Many financial regulators have issued warnings linked to token sales, including the Gibraltar Financial Services Commission (GFSC).

pwc

Blockchain – the future

Accounting and tax considerations:

Holdings in cryptocurrencies and virtual tokens

Entities which hold cryptocurrencies and tokens will need to appropriately classify, value and disclose them in their financial statements.

This is a challenging task as the current accounting standards do not provide specific guidance for cryptocurrencies or holdings in virtual tokens. The accounting standard under International Financial Reporting Standards (IFRS) which seems to best fit cryptocurrencies for the time being is IAS 38 on “Intangible Assets”. An intangible asset by definition is “an identifiable non-monetary asset without physical substance”. This standard also allows the assets to be held at fair value providing there is an active market – which would seem to be the case for cryptocurrencies.

However, there is an argument that the current disclosure requirements under IFRS do not provide sufficient information for users of the financial statements when cryptocurrencies are involved. This is will be an area of consideration for current preparers of financial statements and as well as for standard setters.

There are also tax considerations when holding cryptocurrencies and we must consider how any gains on cryptocurrencies will be treated by tax authorities.

Given the current Gibraltar tax framework one could suggest that any gains on holdings in cryptocurrencies would be considered a capital gain and therefore not taxable in Gibraltar.

Issuance of virtual tokens

The accounting behind the issuance of virtual tokens is a complex matter that an entity needs to consider when undertaking any form of token sale. Depending on the nature of the token this could be seen as the issuance of a security and the entity could fall under securities regulations.

Entities issuing tokens which will be spendable on a platform at a future date could potentially be accounted for as deferred revenue, however there are tokens which fit the properties of a financial liability and possibly even equity. The accounting for such tokens in an entity’s financial statements will also have an impact on taxation for these fundraising activities.

It is important that businesses seek professional advice and structure their operations in the most appropriate manner.

Gibraltar

Gibraltar is an innovation-friendly jurisdiction which is looking to establish an environment for entities to undertake DLT business in a safe and compliant manner.

There are also a number of tax and VAT advantages for companies looking to set up and run their Blockchain based business in Gibraltar.

The future

At PwC, we feel that Blockchain will shape the future of business and look forward to advising our clients in this space.

For more detailed information, please contact:

Colin Vaughan
Territory Senior Partner
+350 200 73520
colin.p.vaughan@gi.pwc.com

Lalit Khatwani
Assurance & Advisory Director
+350 200 66842 ext 308
lalit.khatwani@gi.pwc.com

Patrick Pilcher
Tax Director
+350 200 66842 ext 309
patrick.s.pilcher@gi.pwc.com

Nathan Catania
Assurance Manager
+350 200 66842 ext 229
nathan.catania@gi.pwc.com

Or your usual PwC Contact.

Telephone: +350 200 73520
www.pwc.gi

pwc