

Understanding Initial Coin Offerings

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Initial coin offerings (ICOs) and token generation events have radically changed the way some businesses raise capital for business development and expansion. While their rapid uptake has so far been confined to niche operations, the potential of these new forms of fundraising is vast.

The period from December 2017 to June 2018 witnessed the dazzling rise of ICOs as a way in which companies raised funds. Over US\$19 billion (\$26 billion) was raised over this period, according to CoinSchedule.com, which coincided with peak prices of popular crypto currencies such as bitcoin at around US\$19,780.

With the collapse of prices of crypto currencies, ICOs raised US\$4.3 billion from the second half of 2018 to February 2019.

Blockchain technology and ICOs

The evolution of crypto currencies and digital tokens is underpinned by blockchain technology. A blockchain is essentially a growing list of digital blocks consisting of records and data of transactions that are linked through encrypted code.

An ICO involves a company raising funds through the sale of digital tokens carried out on the internet or other widely used technology platform. The company invites prospective buyers to make offers to purchase the digital tokens made available for sale pursuant to the ICO.

The company will set out technical details of the company's blockchain platform, how the tokens are to be used on such platform and other rights or benefits associated with the tokens, information on the company's management and advisers, as well as the terms of the ICO (such as the number of tokens to be sold, how proceeds would be deployed, and allocation of tokens to management, developers and reserved pool). This technical whitepaper may be updated from time to time, and is intended to be non-legal in nature.

The company will then determine the allocation of digital tokens, to be sold and transferred to the successful buyers' digital wallets. Successful buyers will pay for their tokens either in crypto currency (most commonly, in bitcoin or ethereum) or fiat money. If the company's digital tokens are listed by the company on a crypto exchange, buyers can trade their tokens on such a crypto exchange.

The price of the tokens could appreciate if there is demand for such tokens; thereby resulting in an increase in value of the tokens held by the company as reserved pool or by founders and management.

Types of token offerings

ICOs can generally be classified as utility token offerings (UTOs) or security token offerings (STOs).

The regulations and laws could vary among different jurisdictions. In some jurisdictions, an UTO would be largely unregulated, while an STO would need to comply with existing securities laws. There are jurisdictions where both UTOs and STOs are regulated, and the issuer will have to comply with the relevant regulations and laws in order to undertake either an UTO or STO.

In an UTO, there is no dilution of equity or control in the company due to the sale of the utility tokens. Further, there would be no economic exposure to the economic benefits (such as revenue or profits) generated by the company and/or its blockchain platform. Utility tokens typically provide access to a specific product, network, platform or service of the company that is built on the blockchain platform. These could be an ecommerce market place, a hospitality company, a ride hailing company or co-working

space that only accept its respective digital tokens as a form of payment.

In an STO, the company is raising funds through the sale of security tokens. In many jurisdictions, security tokens are regulated as securities or structured financial instruments. Typically, security tokens confer rights to economic benefits generated by the company and/or its blockchain platform. Holders of security tokens are typically not considered to be shareholders of a company but would share the economic benefits generated by the company, with shareholders of the company.

Potential challenges

A company seeking to undertake an ICO should consider the tax treatment which may vary between different jurisdictions in relation to funds raised. Where the ICO involves the company selling utility tokens, the funds raised would likely for tax purposes be regarded as revenue in nature and taxed accordingly. Further, goods and services tax may also be charged.

Funds raised by a company via an ICO involving security tokens would likely for tax purposes not be regarded as revenue in nature, given that security tokens are more akin to securities/ structured financial instruments.

Prices of major crypto currencies (such as bitcoin and ethereum) were subject to wide fluctuations in 2018. Where the company receives funds in crypto currency in respect of its digital tokens sold in its ICO, the company may wish to consider deploying a hedging strategy.

With the advancement and increasing usage of blockchain technology, an ICO could be an effective way for the company to raise funds for

ICOs in Singapore

Singapore is regarded as an ICO-friendly country. According to a study conducted by the Singapore Venture Capital & Private Equity Association in February 2019, Singapore ranked third globally in terms of cumulative amount of funds raised from ICOs, with the US and Russia in first and second place, respectively. Approximately US\$1.8 billion was raised in Singapore between 2014 and July 2018.

Singapore does not presently have any legislation specifically regulating ICOs, unlike Japan and Thailand which have issued regulations for ICOs.

The Monetary Authority of Singapore (MAS) has however issued a Guide to Digital Token Offerings in 2017, which was updated on 30 November 2018 and 5 April 2019 to address new variations of ICO structures and digital tokens that have emerged in the market since the first edition.

The Guide provides a roadmap for the application of existing financial regulations administered by MAS to offers of digital tokens, or the carrying out of digital token-related activities, in Singapore. However, the provisions of the Guide are “not exhaustive, have no legal effect and do not modify or supersede any applicable laws, regulations or requirements”.

An ICO involving the sale of digital tokens structured as utility tokens would not be subject to securities regulations in Singapore. Where the digital tokens are structured in the form of securities, the ICO must comply with existing securities laws in Singapore aimed at safeguarding investors’ interest. These include regulations pertaining to prospectus requirements, and requirements to hold intermediary or exchange operator licences. Further, intermediaries involved in digital token-related activities are also required to comply with existing rules on anti-money laundering and countering the financing of terrorism.

its blockchain platform project and to receive such funding without diluting equity or control.

Blockchain technology has the potential to fundamentally transform payment transactions, how business is conducted, how companies raise funds, how banks work, and how information gets stored and shared. Digital tokens offer a chance to lower costs, reduce risk and enhance efficiency. Unchecked, however, crypto currencies and digital tokens can cause extensive disruption to systems and processes in the financial ecosystem, magnifying losses and gains exponentially.

Regulators have to work hand-in-hand with developers of the blockchain technology and its participants to ensure checks and balances in the transformation of financial systems. ■

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