

**Initial Coin Offerings (ICOs) and Security Token Offering (STOs) in
Cyprus**

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Introduction

It is a safe bet to say that any person interested in technology, or business, or even just general global affairs must have, by now, come across the term ICO. Ever since the advent of Bitcoin almost a decade ago, the mother-tech behind it - Blockchain, has revolutionized many fundamental aspects of online operations. And this is only the beginning. Blockchain by the very nature of its technology renders banks and other intermediaries unnecessary, a characteristic which is of much use to entrepreneurs looking to raise funds.

Raising capital is one of the innumerable areas which has had its horizons largely broadened by Blockchain. This has been possible through Initial Coin Offerings or ICOs. The term ICO has been manifestly fashioned after IPO, which is universally known as an Initial Public Offering, made by a company to raise capital from the general public by offering stock in return for the first time.

In an ICO a venture raises the capital required by it by providing blockchain-secured assets like coins, or tokens, mostly in return for crypto-currencies. Rarely issuers offering an ICOs opt to raise funds in regular currencies too. This mode of raising capital is most popular but not limited to Start-ups which have traditionally relied on venture capital for funding. Like IPOs these funds are then used for product development or furthering the growth of the business venture.

One of the key differences is that while the offered stock means the same kind of rights and opportunities for all types of IPOs, in ICOs the exact offering provided via a token is subjective and depends on how the rights ensued to the token are defined. This can include being offered cryptocurrencies, the right to use the product or services being developed, the right to vote on such development, right to access the value proposition of the enterprise etc.

In the last five years, there have been more than \$18 billion raised by Initial Coin Offerings globally and more than two dozen of these have raised more than \$100 million independently.

Advantages of an ICO

- **Gauge user demand** - It is a great way to gauge user demand for the product or service being created as the people purchasing the tokens issued in ICOs are often interested in the value proposition of the venture as direct potential customers, and are granted rights to access in the form of such tokens.
- **No intermediaries** - It helps in the creation of a decentralized network free from intermediaries thereby resting the value of the platform or network with the token holders and not the intermediaries. Thus, the people working on developing such decentralized platforms can be incentivized while also keeping the platform free of centralized control. Open source organizations like Wikipedia would benefit enormously from such structures.
- **More accessible to the general public** - ICOs have made the investment in start-ups and other companies more accessible to the general public and it is no longer limited to only venture capitalists or rich corporate bosses.
- **Secure token contracts** - The token contract makes the rights of the holders and terms of usage of token unalterably clear even before the ICO thus providing stability and security for investors.
- **Investment from anywhere in the world** - Businesses are no longer geographically restricted when raising funds and they can have funds from all over the world. Similarly, the investors can invest in any ICOs promising to them regardless of where they are situated geographically.
- **Greater Liquidity** - ICO tokens mostly offer better and faster liquidity as compared to venture capital and IPOs.

Options in Cyprus

Cyprus offers two main routes to an ICO –

- **To incorporate a Cyprus company.** The most popular type is a Limited Liability company for these purposes. The process is fairly simple and all procedures very efficient and time-saving. There are provisions for payment of an express fee to make the already fast process even faster. One needs to provide all the required documents like address and identity proof, memorandum and articles of association etc, along with an application. The name of the company is registered next. A certificate of incorporation is issued by the Registrar of Companies. It is also required to register with the tax authority and get tax-ID for the business. One can also apply for an appropriate license from the Securities Commission if the company deals in financial assets and markets.
- **To start a Cyprus Investment Fund.** It is required to present a whitepaper for the fund which outlines the objectives and functioning process of the firm to the Securities and Exchange Commission. Also, an investment fund must register with the Commission. The process for registration here too is hassle-free and straightforward. The approval of the Cyprus SEC is essential for conducting an ICO through this method.

Step-by-Step Guide to an ICO

The following steps are essential to the ICO process –

- **Solve a Problem** – This applies to all start-ups regardless of ICO or not. There must be an idea to solve an existing problem.
- **Team** – There must be a skilled and balanced team to look after the different aspects of developing the business. The ability of the team to pivot and adapt often becomes the deciding factor in a business's success or failure.
- **Market Analysis & Planning**- Key decisions such as the business model, product features, ICO terms etc need to be fixed. These are taken after carefully studying the sector in which the company intends to engage and the competition in the same.
- **Registration** – Registering the company in a friendly jurisdiction makes a lot of difference.
- **Mentors and Advisors** – Getting experienced mentors to provide valuable insights into the sector, the market or the vision of the company often gives start-ups the chance to save a lot of resources by avoiding initial mistakes.
- **Marketing** – Introducing the idea to the world. Communicating the vision to the first movers and generating interest in the product being offered through increasing engagement on social media and other networks. The website launch to answer all queries and FAQs is an essential part of the process.
- **Whitepaper** – Whitepaper is just like the prospectus of a company launching an IPO. It describes the vision of the company, how it intends to solve the problem, the business model of the company and other such relevant details which the public would be interested to know before proving the company

with their money. It promotes trust in the company and their vision and it advertises the fundraising as worthwhile. In the case of ICOs it details the total capital needed, terms of the contracts, expiry dates etc. It is also a preferred practice to provide all necessary details about the tokens in the whitepaper. It defines the rights accrued via the tokens and their usability. It also informs about the technicalities of the product, the teams, and the financial projections for the future. More technical and complex yellow-papers and position-papers are also becoming popular by the day.

- **Legalities** – In the complex and unexplored territory of Crypto it becomes integral to ensure the best possible legal representation. This comes in handy while preparing the contracts between issuers and holders of tokens. Such contracts become necessary because in most ICOs the tokens are offered in a way which keeps them from being treated as securities thereby preventing any involvement of regulators. This also means that there is little to no protection for the rights of the investors and token holders. Thus, the rights to profits or the voting rights are protected for the holders by attaching them to the tokens in an unalterable fashion.
- **The Final Day** – On the day of the ICO, all measures should be taken to ensure cybersecurity and smooth functioning of the website. Continual Social media engagement may help in bringing a final boost to the offering.
- **Transparency and Reliability after ICO** – It becomes essential to keep the investors updated on the progress of the vision. This can be done through subscriptions and social media updates. Getting an early prototype is one of the best ways for proof-of-concept. This can even be done before the ICO and is certainly help with getting better results.

More about Tokens

Tokens are one of the most important, if not the most important, part of the ICO process. They define with exactitude the rights of the holder. The purpose of the tokens and their nature is defined pre-ICO and is unalterable in nature. They can be issued as a currency, commodity, security depending on the intent and use to the issuer. Some tokens are just tickets to use the service or product being developed by the issuer; others let a holder vote on certain pre-decided matters relating to the development; others are currencies which can be exchanged for other Cryptocurrencies. There are no fixed universal types of classifying tokens and any present classifications are not mutually exclusive, meaning that one token can belong to more than one such category.

Some of the popular types are –

- **Strictly value based tokens** – These are basically cryptocurrencies which can be used to pay for, buy, or exchange any other currencies, products or services. They give no rights to the holder against the issuer other than their value as a cryptocurrency. This value may rise as the company launching the ICO grows and becomes popular.
- **Utility tokens** – These are the most common form of tokens issued in ICOs and give the holder the right to access or use the application, product or services being developed by the issuer. First adopters of new technologies are often the ones who invest using these tokens to have the fastest and earliest

access to new technologies. They lack the value held in Cryptocurrencies and are just tickets to entry. Utility tokens can sometimes produce undesired outcomes, like if the attempt to create network-effect backfires when the holders see more value in holding the tokens than using them to access the application or platform. This can be solved by issuing token whose value increases as the demand for the platform or service increases.

- **Asset tokens** – These tokens are in the form of a promise in future to the holders. Like a promise of a share in profits in the future. They are debt or equity claims ensure against the issuer. Thus, by their very nature, they invite the regulations applicable to securities like shares which are offered in IPOs.
- **Pre-Sale token** – These are often used to finance the expenses of the original ICO. Thus, the pre-ICO tokens provide the investors with the right to get another token issued after the ICO.

Regulations in Cyprus

Not only in Cyprus but all over the world regulatory bodies have struggled to come up with specific regulations applicable to ICOs. Some of the most important aspects of this have been to find a proper classification for the tokens issued. For an instance, qualifying as securities would invite all the regulations relevant with securities and similarly with qualifying as commodities or currencies. There is the other pertinent question about tax-liability involving the sale of tokens after the ICOs.

Presently there is no regulation, on paper, in Cyprus governing ICOs. However, the ground reality is much different as the current regulation still needs to be adhered to if the issuer wants to avoid strict penalties and other liabilities. The primary regulations to be followed depends upon the nature and type of the tokens issued. The Cyprus Securities and Exchange Commission follows the guidance of the European Securities and Markets Authority. The ESMA released a statement in late 2017 stressing the importance of ICOs to adhere to regulations especially when their tokens or coins offered qualified under the definition of financial instruments. The specific regulations mentioned in the statement were –

- The Prospectus Directive
- The Markets in Financial Instruments Directive
- Alternative Investment Fund Managers Directive
- Fourth Anti-Money Laundering Directive

In Cyprus, the regulation applicable to an ICO depends most importantly on the type and structuring of the ICO and the rights ensured via the tokens. Thus, it becomes crucial to employ the services of a knowledgeable legal representative in order to avoid having to adhere to undesirable regulations.

If the tokens being offered classify as financial instruments then they are to be regulated under the laws applicable to securities and their trade & investments. This can be an unnecessary complication for a lot of ICOs. This mostly takes place with Asset tokens as payment tokens and utility tokens are not classified as securities in any condition.

Why Cyprus is the ideal ICO destination

- Cyprus is one of the most Crypto friendly jurisdiction in the world.
- Such is the popularity of blockchain on the island that the University of Nicosia became the first university in the world to accept the fee in a Cryptocurrency.

- There are specialized education programs being taught on blockchain and crypto management in the country making it a global leader on the subject. It also produces skilled experts on the topic as a result.
- At 12.5% Cyprus has one of the lowest corporate tax in Europe and in the world.
- It provides for highly skilled human resource in all areas like legal, accountancy, marketing etc.
- Cyprus, while maintaining low tax rates is also an EU member and in the EUCD white-list making it highly reputable for transparency and stability.
- There is no withholding tax on dividends accrued from subsidiaries or on payment of dividends to non-resident shareholders.
- Cyprus has Double Tax Treaties with more than 55 countries thus, protecting against double taxation. This includes major economies like USA, UK, India, China etc.
- The government is acutely business friendly and all procedures and formalities are time-efficient and straightforward.
- Most people speak functional English.
- The crime rates in Cyprus are some of the lowest in the world.

Tax Liability in Cyprus

Just like regulation the tax liability involving ICOs is also dependent on the nature of the tokens issued and the structure of the ICO. Thus, the tax liability incurred by the different types of tokens differs significantly.

- Strictly value based tokens/Cryptocurrency –Corporation tax is applicable on the profits at the rate of 12.5%. VAT exemption is probable in this case under Article 135(1)(e) of the EU VAT Directive 2006/112/EC although there is not much legal precedent in this area.
- Utility tokens – These can be exempt from corporation tax as they are promises-in-future. However, the 12.5% rate of taxation will be applicable on the profits when the services promised via tokens are finally provided to the holder. We believe that there can be a case made for Utility token to be exempt from the VAT at the time of issuing of the tokens.
- Asset tokens – If these qualify under the definition of share capital then a one-time Capital tax of 0.6% would apply. There also several ways to reduce or even completely save the raised capital from corporate tax by reporting it as a liability of the company and not the revenue. There can be a case made for exemption of VAT on asset tokens under the Articles 135(1)(b) and the Articles 135(1) (f) of the EU VAT Directive.

Conclusion

Valdis Dombrovskis the current European Commission Vice-President for the Euro and Social Dialogue in February 2018 stated in his speech at the Roundtable on Cryptocurrencies that, *“Initial Coin Offerings have become a way for innovative firms in this field to raise substantial amounts of funding.”* These words ring true for not just Europe but the entire world. However, much like any other great opportunity, this brings with it some significant obstacles and risks.

The absence of a regulatory framework has not stopped the top business destinations in the world to adopt and promote this innovative method of entrepreneur finance. In the future, this space will likely see a lot of significant developments and change. In such turmoil the nations with a lead today will also most likely emerge to be the leaders of tomorrow.

Cyprus is one of the few destinations in the entire world which provide the most favorable, thriving environment to ICOs and blockchain based business in general.

Simon Zenios & Co specializes in ICO services

As manifest in many of the paragraphs above the services of a skilled and informed legal representative become essential when conceptualizing and launching an ICO. Not only is the deep knowledge useful in maneuvering the company through favorable categories to save on taxation and regulations, but it is also helpful in giving legitimacy to the issuers intentions by ensuring complete investor protection according to all prescribed standards.

The developments in the area of ICOs have meant that firms offering ICO legal services must be educated in the area in order to be in a position to protect the interest of their clients. At Simon Zenios & Co LLC our lawyers have been closely following the developments in this area and have acquired the specialized legal knowledge in order to be in a position to advise and assist our clients.

Our lawyers understand that the process of running your ICO will have legal implications stemming not only from the ICO documentation (White paper, T & C's etc.) but also from marketing material. It is vital that clients running an ICO are advised as to the legal implications that can arise not only from the content of the documents but oftentimes from what is not included in the documents. Above all, we understand that legal certainty and clarity should govern the relationships between the ICO team and coin/token buyers, holders or users.

The process of running an ICO also presents legal implications in regards to token design which cannot be overlooked. Depending on its design, your ICO's token may be considered a financial instrument and could thus be subject to financial regulation. This is why it is vitally important to have legal advice and support throughout the process.

Our team of ICO lawyers will be able to advise and assist you throughout the process which will begin with an introductory call with our team of experts, the point of which is for our team to understand your requirements and objectives. Following this, we can then provide you with a quote for our ICO Legal services. If the quote is accepted and you decide to engage our legal services, the next step will be for us to collaborate with your team and come up with a detailed legal services plan.

We offer a range of Legal Services including:

ICO Legal Services

- Legal Support during the Whitelist Period, Pre-ICO & ICO period.
- SAFT Agreement.
- Token Purchase Agreement.
- Preparation and drafting of the ICO Private Placement Offering Document.
- Preparation and drafting of the pre-Crowd Token Offer (Pre ICO) and Crowd Token Offer Agreement (ICO).
- Legal Report for the Token (Security or Utility?) after the Reviewal of the Whitepaper (Opinion Letter from our Law Firm – Requirement for the Bank & the Exchanges).

- Legal Disclaimer for the Whitepaper.
- Privacy Policy.
- Terms of Use.
- Security Policy.
- Legal Review of the Whitepaper.
- Legal Review of the Website.
- Legal Review of all Social Media Platforms.
- Legal assessment for the ICO's compliance with the current regulatory framework.
- Legal assessment of the application of the Token and ICO within the current regulatory framework for investment services.
- Extensive legal review of the Token and ICO's compliance with other applicable legislation (Data Protection Regulations, Consumer Protection Regulations etc.).
- KYC Legal Advice and solutions for your ICO.

ICO Corporate & Accounting Services

- Token Company Incorporation and maintenance.
- Marketing Company Incorporation and maintenance.
- E-money Company Formation & Licensing.
- Tax and VAT Services.
- Corporate Legal Services.
- Administrative and Fiduciary Services.
- Accounting services through our Associate Accounting Firm.

Other Non-Legal ICO Services

- Smart contract preparation and drafting.
- Creation of multi-signature wallet.
- Issuing of Tokens (ERC20 compatible).
- Listing on the Exchanges.

For any queries regarding any aspect of ICOs or blockchain companies in general, or any other legal matter under the sun, we are always available.

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