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## Digital Assets: Certain Cayman Islands law issues to consider

Based on our experience of advising initial coin offerings (ICOs) and security token offerings (STOs) and of undertaking legal due diligence for institutional clients seeking to acquire tokens in ICOs and STOs, in this brief update, we discuss a few of the issues that should be considered when determining which offshore jurisdiction to incorporate a legal vehicle in order (i) to reduce your risk of contravening Cayman Islands law, (ii) to facilitate listing on crypto-exchanges, and (iii) to facilitate better relationships with other participants in the growing digital assets space (e.g. banks to open accounts, institutional investors and investment funds which will undertake due diligence as part of the process of acquiring tokens in an ICO or STO).

### 1. Tax

The Cayman Islands is a tax neutral jurisdiction. There are no direct taxation of any kind on Cayman entities. Structuring issues will largely be driven by business needs and onshore tax considerations, and onshore regulatory issues. There are no income, corporation, capital gains or withholding taxes or death duties. It is possible for all types of Cayman legal structures (exempted company, LLCs, foundation companies, unit trust, and limited partnerships) to apply to the Cayman Islands government for a tax undertaking that the legal structure will not be subject to direct taxation, for a minimum period, which in the case of a company is 20 years, and in the case of an LLC, unit trust and an ELP is 50 years.

### 2. Cayman Islands laws and regulations governing digital asset offerings, formation and operation of cryptocurrency exchanges, etc.

There is no specific existing legislation or regulation regarding cryptocurrency offerings (e.g. ICOs and STOs), cryptocurrency exchanges or investment vehicles investing in cryptocurrency. There are no restrictions or licensing requirements that specifically govern the holding, management or trading of digital assets, whether in a personal capacity or doing so as a manager, trustee or advisor for the account of others. The application of existing laws needs to be considered in relation to this developing digital assets space. It is worth noting that the Cayman Islands Government has published a consultation paper in which it seeks commentary on its proposals for a regulatory framework for virtual asset service providers in order to regulate token offerings and ICOs/ITOs. The consultation paper discusses registration being imposed on issuers prior to the sale, and minimum notice requirements – like a prospectus. Issuances above a certain threshold would have to be undertaken via a licensed or regulated trading platform. Custodial services and trading platforms would be subject to licensing requirements. The regulatory framework would also cover a sandbox license to test out new technologies, which Fintech service providers may apply for.

Until a regulatory framework for virtual asset service providers is introduced, the following existing laws may be applicable in the digital asset space and should be carefully considered by promoters, investors and their advisors:

- i. The Cayman Islands Securities Investment Business Law (As Revised) (“SIBL”) defines securities by reference to a list of instruments, including shares and stock of any kind in the share capital of a company, debentures and any other instruments creating or acknowledging indebtedness other than certain exceptions specified, instruments giving entitlements to securities, certificates conferring rights with respect to securities, etc.

The term “instrument” refers to any record and specifically includes an electronic record as defined in the Electronic Transactions Law (2003 Revision), *i.e.* a record processed and maintained by electronic means.

Accordingly, CIMA may qualify coins/tokens issued on blockchain as stock or debt if the rights attached to the coins/tokens (as represented in the White Paper or the token sale documentation) resemble rights normally attached to equity interests or debt.

- ii. In certain circumstances, a registration with or a license from CIMA may be required:
  - (a) under the Cayman Islands Money Services Law (As Revised), if the coins/tokens issued could give access to money transmission or currency exchange services;
  - (b) under SIBL, if the coins/tokens may qualify as securities, for all persons engaging, “in the course of business”, in securities investment business, *i.e.* among other things buying, selling, subscribing for or underwriting securities as agent or principal, arranging deals, managing securities, or advising an investor on buying, selling, underwriting, subscribing for or exercising any right in securities;
  - (c) under the Cayman Islands Mutual Funds Law (As Revised) if the issuer of the coins/tokens is essentially a collective investment scheme and the coins/tokens are attached to redemption rights for investors; and/or
  - (d) under the Cayman Islands Private Funds Law, 2020, if the issuer of the coins/tokens is essentially a collective investment scheme and the coins/tokens carry an entitlement to participate in the profits or gains.

The following Cayman Islands statutes and regulations should be considered when structuring a digital asset business through the Cayman Islands:

1. the Securities Investment Business Law (SIBL);
2. the Proceeds of Crime Law (PCL), the Anti-Money Laundering Regulations (the AML Regulations) and existing guidance notes, and the Terrorism Law;
3. the International Tax Co-operation (Economic Substance) Law (the Economic Substance Law).
4. the Money Services Law (MSL);
5. the Mutual Funds Law (MFL);
6. the Private Funds Law (PFL);
7. the Stock Exchange Companies Law;
8. the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS);
9. the beneficial ownership regime in the Companies Law and various other statutes; and
10. the Bank and Trust Companies Law.

**This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific advice, please contact either:**

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