IN-DEPTH

Virtual Currency Regulation

NEW ZEALAND

LEXOLOGY

Virtual Currency Regulation

EDITION 7

Contributing Editor

Paul Anderson

Squire Patton Boggs

In-Depth: Virtual Currency Regulation (formerly The Virtual Currency Regulation Review) is a country-by-country guide to recent legal and regulatory changes and developments in the field of virtual currencies, which also looks forward to expected global trends in the area. It provides a practical analysis of developing regulatory initiatives aimed at fostering innovation, while at the same time protecting the public and mitigating systemic risk concerning trading and transacting in virtual currencies.

Generated: August 14, 2024

New Zealand

Tom Hunt and **Fred Ward**
Russell McVeagh

Summary

Introduction

Virtual currencies and services related to virtual currencies in New Zealand are largely regulated by existing, technology neutral legislation. Given that the rights and functions created in respect of virtual currencies are flexible, each virtual currency or service associated with virtual currencies will be regulated according to its specific properties.

For the purposes of this chapter, the term 'virtual currencies' includes all digital tokens that are recorded on a blockchain ledger.

Securities and investment laws

The Financial Markets Authority (FMA) has responsibility for the regulation of financial products in New Zealand, and the Financial Markets Conduct Act 2013 (FMCA) is the principal piece of legislation that regulates financial products. The primary purposes of the FMCA are to promote the confident and informed participation of businesses, investors and consumers in New Zealand's financial markets, and to promote and facilitate the development of fair, efficient and transparent financial markets.

Offers of financial products in New Zealand are regulated by the FMCA and regulations made under the FMCA (the Regulations). The FMCA and the Regulations:

1. impose fair dealing obligations on conduct in both the retail and wholesale financial markets;
2. set out the disclosure requirements for offers of financial products;
3. set out a regime of exclusions and wholesale investor categories in connection with the disclosure requirements;
4. set out the governance rules that apply to financial products; and
5. impose licensing regimes.

In general under the FMCA, issuers of financial products must comply with various fair dealing obligations and certain disclosure, governance and operational obligations (subject to certain exceptions). The fair dealing provisions are concerned with misleading or deceptive conduct, and false, misleading or unsubstantiated representations. Failure to comply with the appropriate obligations may result in criminal or civil liability, or both, under the FMCA, and may result in material financial penalties, imprisonment, or both.

At a high level (and subject to the detail below), the disclosure and governance provisions of the FMCA will only apply to the offer of a virtual currency if:

1. it is offered in New Zealand;
2. it is made under a regulated offer; and
3. the relevant virtual currency falls within one of the categories of financial product in the FMCA or is otherwise designated as a financial product by the FMA.

i Offers in New Zealand

The obligations imposed under the FMCA apply to offers of financial products in New Zealand, regardless of where the issue occurs or where the issuer is based. An offer is deemed to have been offered in New Zealand if it is received by a person in New Zealand (including electronically), unless the issuer can demonstrate that it has taken all reasonable steps to ensure that persons in New Zealand to whom disclosure would otherwise be required under the FMCA may not accept the offer.

ii Regulated offers

An offer of financial products that requires disclosure under the FMCA is a regulated offer. An offer of financial products for issue requires disclosure to investors unless an exclusion applies to all persons to whom the offer is made. Certain specified offers of financial products for sale will also require disclosure to investors. The form and content of the disclosure required in relation to each financial product are set out in the Regulations and are tailored according to the characteristics of the particular financial product being offered.

The FMCA provides that a person must not make a regulated offer unless the issuer has prepared a product disclosure statement (PDS) for the offer, has lodged that PDS with the Registrar of Financial Service Providers (the Registrar) and has prepared an online register with the prescribed information.

An offer that is not a regulated offer will still be subject to the fair dealing provisions in the FMCA. As noted above, these provisions prevent people from making false or misleading statements or unsubstantiated representations. Similar obligations are imposed under the Fair Trading Act 1986.

In October 2021, the FMA issued guidance on advertising offers of financial products under the FMCA, broadening the definition of 'advertisement' when applying the FMCA fair dealing provisions. The FMA provides that an advertisement can be via any medium (for example, social media) and may not need to specifically mention an offer of a financial product or even a financial product to be captured by the fair dealing principles and advertising expectations outlined in its guidance.

iii Types of financial product

There are four categories of financial products under the FMCA:

1. debt securities;
2. equity securities;
3. managed investment products; and
4. derivatives.

Virtual currencies are regulated by the FMCA only to the extent that a particular virtual currency meets the definition of one these categories of financial product. The FMCA sets

out a hierarchy of financial products, such that a virtual currency that would prima facie satisfy the definition of more than one category of financial product will default into only one category.

Debt securities

A debt security is defined as a right to be repaid money, or paid interest on money, where that money is deposited, lent to or otherwise owing by any person. Importantly, for the purposes of the definition of debt security, money does not include money's worth. Several prominent virtual currencies, such as Bitcoin and Ether, do not constitute debt securities because there is not a right to be repaid money or to be paid interest by the issuer, or anyone else. Fiat wallets operated by virtual asset service providers could be debt securities if the underlying fiat currency is not held on bare trust for the investor.

Equity securities

An equity security is narrowly defined in the FMCA as a share in a company, an industrial and provident society, or a building society, but does not include a debt security.

While a blockchain could mimic a traditional share register (with each unit of the virtual currency representing a single share, and shareholders being able to represent trades in those shares by trading in those units), the virtual currency itself would not constitute a share in a company, an industrial and provident society, or a building society. As such, a virtual currency could not be an equity security as defined in the FMCA. This is the case even where a virtual currency gives holders rights traditionally associated with equity (such as certain profit and governance rights).

Managed investment products

A managed investment product refers to an interest in a managed investment scheme, which is broadly defined to include any scheme:

1. the purpose or effect of which is to enable participating investors to contribute money to the scheme to acquire an interest in the scheme;
2. where the interests are rights to participate in or receive financial benefits produced principally by the efforts of others; and
3. where participating investors do not have day-to-day control over the operation of the scheme.

If a product is classified as a debt security or an equity security it would not be a managed investment product.

If a virtual currency is classified as a managed investment product, the FMCA imposes significant disclosure and governance requirements on the underlying managed investment scheme. These requirements include registering the scheme with the Registrar; complying with reporting and governance requirements; and requiring the appointment of

a licensed manager and licensed independent supervisor, each of which owe statutory duties of care to investors.

In practice, the nature of a virtual currency may make it impractical or impossible to fully comply with these additional requirements. For example, one of the functions of the manager of a managed investment scheme is to manage the scheme property and investments. This requirement is not compatible with a decentralised blockchain where the scheme property is held in (for example) an Ethereum account associated with a smart contract. If there were a manager who had overall control over this account, the decentralised nature of the blockchain and the autonomous nature of the smart contract would be undermined.

By way of example, the Decentralised Autonomous Organisation (DAO) and DAO tokens, which were the subject of a report in 2017 by the United States' Securities and Exchange Commission, could have been characterised as a managed investment scheme and managed investment products (respectively) under the FMCA.

Derivatives

A derivative is defined as an agreement under which consideration is, or may be, payable to another person at some future time and the amount of the consideration is ultimately determined, is derived from or varies by reference to (in whole or in part) the value or amount of something else (including an asset, interest rate, exchange rate, index or commodity). A derivative does not include, inter alia, a debt security, equity security or managed investment product. Certain virtual currencies that are tied to the value of fiat currencies, are tied to commodities such as gold (stablecoins) or track the value of other securities like shares could constitute a derivative under the FMCA.

iv FMA designation and exemption powers

The FMA has certain designation powers under the FMCA, including the power to designate:

1. that a security that would not otherwise be a financial product is a financial product of a particular kind. A security is an arrangement or facility that has, or is intended to have, the effect of a person making an investment or managing a financial risk. The FMA has expressed the view that all digital tokens issued in an initial coin offering (ICO) will constitute a security for the purposes of the FMCA; or
2. that a financial product is, or is to become, a financial product of a particular kind. For example, if a virtual currency fell within the definition of managed investment product, the FMA could designate such interests as equity securities. In that case, the issuer would still be required to provide disclosure to investors but would not be subject to the prescriptive governance obligations described above.

Alternatively, the FMA has the power to exempt any person or class of persons, or any transaction or class of transactions, from compliance with certain obligations imposed under the FMCA. For example, the FMA could exempt an issuer of a virtual currency

classified as a managed investment product from some of the provisions that would otherwise apply to the issuer.

Banking and money transmission

The Reserve Bank of New Zealand (RBNZ) has responsibility for the prudential regulation of registered banks, non-bank deposit takers and insurers in New Zealand. The RBNZ does not directly regulate virtual currencies. However, as New Zealand's Central Bank, the RBNZ is responsible for promoting the maintenance of a sound and efficient financial system.

Money transmission services in New Zealand are regulated separately by the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the FSP Act) and the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act). As the anti-money laundering regime is discussed in Section IV, this section is limited to the FSP Act.

Subject to certain limited exceptions, the FSP Act applies to every person who is in the business of providing a financial service (a financial service provider) if that person:

1. provides financial services to persons in New Zealand;
2. is, or is required to be, a licensed provider under a licensing enactment (which includes registered banks, authorised financial advisers, licensed insurers and certain licensed supervisors);
3. is required to be registered under the FSP Act by any other enactment;
4. is providing the service in certain prescribed circumstances; or
5. is a reporting entity to which the AML/CFT Act applies.

This scope is subject to subsequent provisions that exclude persons whose financial services are merely accessible by persons in New Zealand, and persons who do not have a place of business in New Zealand and do not provide financial services to retail clients in New Zealand. Those exclusions only apply in relation to the first bullet point above; they do not exclude a person from the registration requirement in the circumstances described in the other four bullet points.

The term financial service includes, inter alia, operating a money or value transfer service, operating a financial product market, and issuing and managing means of payment.

Regulations issued under the FSP Act contain further exemptions that apply in a range of circumstances, including an exemption for overseas providers who do not promote their services in New Zealand, and a range of exemptions for providers whose activities fall below certain specified minimum thresholds.

The core requirement of the FSP Act is that financial service providers must be registered for the relevant financial service on the Financial Service Providers Register (FSPR). Financial service providers that provide financial services to retail clients must also join an approved dispute resolution scheme, subject to certain limited exceptions. The FMA has been taking a strict approach to registration under the FSP Act and issuing public warning

notices where it considers virtual currency providers are actively soliciting business in New Zealand without being registered.

The FMA has issued guidance (the Guidance) stating that in the context of virtual currency services, exchanges, wallets, deposits, broking and ICOs are key activities that may be considered financial services under the FSP Act.[1] By way of example, exchanges allowing virtual currency trading will, according to the Guidance, be operating a value transfer service under the FSP Act. Similarly, the Guidance states that a wallet provider that stores virtual currency or money on behalf of others and facilitates exchanges between virtual currencies or between money and virtual currencies will also be operating a value transfer service.

Additionally, arranging virtual currency transactions will be operating a value transfer service.[2] If a virtual currency service is providing safe-keeping or administration services in relation to virtual currencies, it will be the financial service of keeping, investing, administering or managing money, securities or investment portfolios on behalf of other persons.[3] On this point, the Guidance notes that there may be obligations as a provider of regulated client money or property service (including custodial service) under the FMCA.[4] The Guidance also points out that trading of virtual currencies that are financial products may trigger the need for a licence to operate a financial product market under the FMCA. Furthermore, the Guidance states that providing investment opportunities in virtual currencies will be regulated the same way as providing investment opportunities in traditional assets or financial products.[5] Enforcing the provisions of the FSP Act in relation to public blockchains is somewhat difficult in practice. The primary issue is that a public blockchain may not be managed by one particular entity, but instead may be managed by the relevant blockchain community. The core requirement of the FSP Act – that financial service providers are registered – may prove to be difficult when there is not one person or organisation that is able to register.

Anti-money laundering

New Zealand's anti-money laundering regime is set out in the AML/CFT Act, which applies to reporting entities. A reporting entity includes, inter alia:

1. financial institutions, which are defined as any person who, in the ordinary course of business, carries on one or more of the financial activities listed in the AML/CFT Act. Those financial activities include transferring money or value for, or on behalf of, a customer, issuing or managing the means of payment, and money or currency changing; and
2. any other person or class of persons deemed to be a reporting entity under the regulations or any other enactment.

The AML/CFT Act imposes customer due diligence, reporting and record-keeping requirements on reporting entities. It also requires reporting entities to develop and maintain a risk assessment and a risk-based AML/CFT programme. The AML/CFT Act provides for external supervision of reporting entities by the FMA, the RBNZ or the Department of Internal Affairs (DIA). The functions of an AML/CFT supervisor are to,

inter alia, monitor the level of risk of money laundering and the financing of terrorism involved across all the reporting entities it supervises; and monitor the reporting entities it supervises for compliance with the AML/CFT Act.

Virtual asset service providers (VASPs) who provide financial services fall within the definition of financial institution in the AML/CFT Act.[6] Types of VASPs include virtual asset exchanges, virtual asset wallet providers, ICO providers, and providing investment opportunities in virtual assets.[7] VASPs are primarily supervised by the DIA for compliance with the AML/CFT Act. In March 2020, the DIA released guidance to assist VASPs' compliance with the AML/CFT Act (the VASPs Guidance).

Obligations under the AML/CFT Act generally apply to a reporting entity only to the extent that it provides one of these financial activities to a customer. The term customer is very broadly defined. By way of example, an exchange that allows virtual currency trading could be a reporting entity under the AML/CFT Act, and entities that trade on the exchange could be its customers.

The AML/CFT Act does not specify the territorial scope of the Act. The AML/CFT supervisors have issued guidance on the territorial scope, which states that the relevant financial activities caught by the AML/CFT Act 'must be carried on in New Zealand in the ordinary course of business', and that this implies a place of business in New Zealand. However, this guidance is difficult to apply to blockchain-based technologies where the technology is online, and therefore it is not necessarily carried on in New Zealand even though it is accessible to persons in New Zealand. The VASPs Guidance notes that VASPs registered outside of New Zealand may be considered to be carrying on business in New Zealand if the entity is actively and directly advertising or soliciting business from persons in New Zealand.[8]

In the case of virtual currencies, compared to more conventional circumstances contemplated when the AML/CFT Act was enacted, it can be challenging to interpret the legislation to determine who constitutes a reporting entity and a customer. More practically, the inherent anonymity of many virtual currencies may impose significant challenges for reporting entities to realistically be able to conduct customer due diligence.

In addition, the issues discussed above in relation to the FSP Act also apply to the AML/CFT Act. The lack of a clear owner or manager of a particular virtual currency may make it difficult for regulators to identify the entity that should be complying with the obligations under the AML/CFT Act, and to bring a claim for a breach of obligations. Virtual currencies appeared for the first time in the 2021 FMA Sector Risk Assessment on AML/CFT. The FMA rated derivatives issuers and VASPs as being in the high-risk category for meeting AML/CFT obligations.[9]

While the AML/CFT Act is currently technology neutral (and does not make specific reference to virtual currencies), the legislation has been reviewed. The Ministry of Justice released new regulations in July 2023 that cover virtual currencies specifically. The regulations define virtual asset as a digital representation of value that can be digitally traded or transferred or used for payment or investment purposes. Financial products under the FMCA and digital representations of fiat currency are excluded from the definition. In substance, the new regulations are intended to ensure that all providers of virtual asset services are subject to the AML/CFT Act, including customer due diligence and wire transfer obligations.

Regulation of exchanges

Exchanges are regulated by the FMCA if the exchange constitutes a financial product market. The FMCA defines a financial product market as a facility by means of which:

1. offers to acquire or dispose of financial products are made or accepted; or
2. offers or invitations are made to acquire or dispose of financial products that are intended to result, or may reasonably be expected to result, directly or indirectly, in:
3. the making of offers to acquire or dispose of financial products; or
4. the acceptance of offers of that kind.

Virtual currency exchanges could therefore be regulated if the relevant virtual currency being exchanged constitutes a financial product under the FMCA.

A person must not operate, or represent to others that the person operates, a financial product market in New Zealand unless such person has a licence to operate the market under the FMCA or the market is exempt from licensing. A financial product market is taken to be operated in New Zealand if:

1. it is operated by an entity that is incorporated or registered in New Zealand or by an individual who is ordinarily resident in New Zealand;
2. all, or a significant part of, the facility for the financial product market is located in New Zealand; or
3. the financial product market is promoted to investors in New Zealand by or on behalf of the operator of that market, or by or on behalf of an associated person of that operator. However, a financial product market is not promoted to investors in New Zealand merely because it is accessible by those investors.

As noted in Section III, the FMA has indicated in its Guidance that the licensing regime under the FMCA could apply to virtual currency exchanges.

Licensed market operators must have FMA-approved market rules and comply with certain disclosure and reporting obligations to ensure that every licensed market is a fair, orderly and transparent market.

Regulation of miners

Miners are not expressly regulated in New Zealand. However, there are certain criminal offences, discussed in Section VIII, which relate to accessing computer systems for dishonest purposes. In such a case, miners who choose to improperly access the processing power of another person's computer system to mine a virtual currency would be committing an offence under New Zealand law.

Regulation of issuers and sponsors

New Zealand has a disclosure-based approach to the offer of financial products to the public. An offer of financial products for issue will require full disclosure to investors under the FMCA, unless an exclusion applies (as discussed in Section II.ii).

In addition, certain offers of financial products for sale (secondary sales) also require disclosure. For example, if financial products are issued (but not, inter alia, under a regulated offer) with a view to the original holder selling the products and the offer for sale is made within 12 months of the original issue date, that secondary offer will require disclosure.

As discussed in Section II.ii, a PDS must be prepared for a regulated offer of financial products, and certain information relating to the offer must be contained in a publicly available register entry. The PDS must be lodged with the Registrar, and the register entry must contain all material information not contained in the PDS. Material information in this context means information that a reasonable person would expect to, or to be likely to, influence persons who commonly invest in financial products in deciding whether to acquire the financial products on offer, and is specific to the particular issuer or the particular financial product. Investors to whom disclosure is required must (subject to certain exceptions) be given the PDS before an application to acquire the relevant financial products under a regulated offer is accepted or the financial products are issued.

The Regulations set out detailed requirements for the timing, form and content of initial and ongoing disclosure for financial products, including limited disclosure for products offered under certain FMCA exclusions. The content requirements for a PDS are prescriptive and include prescribed statements and page or word limits. The Regulations impose different disclosure requirements for different types of financial products.

The FMCA comprises an exclusion for offers to wholesale investors, which include:

1. investment businesses;
2. people who meet specified investment activity criteria;
3. large entities (those with net assets of at least NZ$5 million or consolidated turnover over NZ$5 million in each of the two most recently completed financial years);
4. government agencies;
5. eligible investors;

6. persons paying a minimum of NZ$750,000 for the financial products on offer;
7. persons acquiring derivatives with a minimum notional value of NZ$5 million; and
8. bona fide underwriters or sub-underwriters.

Even where an exclusion (including the wholesale investor exclusion) applies, certain disclosure requirements may still apply.

As discussed above, the application of these provisions to offers of virtual currencies turns on whether they are a financial product or are designated a financial product by the FMA.

Criminal and civil fraud and enforcement

The New Zealand courts have held that intangible property is capable of being property for the purposes of criminal law. Accordingly, under the Crimes Act 1961 (the Crimes Act) (the primary piece of legislation that prescribes criminal offences in New Zealand), there are a number of criminal offences that could apply to the use of virtual currencies. These include theft, obtaining property or causing loss by deception, as well as crimes involving computers.

It is an offence to obtain property or valuable consideration by deception, or cause loss to another person by deception. This could cover circumstances in which a person is scammed by a malicious issuer of an ICO, NFT or Liquidity Pool Provider. In this particular situation, the FMCA also provides for offences for misleading or deceptive conduct in relation to disclosure of information made by the issuer under the FMCA.

R v. Glaser confirms that the general offence of theft applies to virtual currencies. However, if that theft was procured by a person hacking another's computer or accounts, prosecution as a crime involving computers may also apply. These include accessing a computer system for dishonest purposes and accessing a computer system without authorisation. As with other parts of New Zealand law, this crime is not concerned specifically with virtual currencies, but is broadly drafted such that the kind of activity above would be covered. This is consistent with the recent trend of courts applying proceeds of crime legislation to virtual currencies.

The New Zealand police have authority to investigate alleged crimes and to prosecute individuals charged with an offence under the Crimes Act in a court (with Crown solicitors as required). The New Zealand courts may impose fines, prison sentences and other penalties prescribed in the Crimes Act where an offender is found guilty (maximum penalties are prescribed by the Crimes Act).

As far as civil law is concerned, the same legal analysis is likely to apply when cash or virtual currencies are obtained by fraudulent means. The difference between criminal and civil action is likely to turn on practical issues, such as the difficulty of identifying – or enforcing a judgment against – a defendant.

In these circumstances, an innocent party may wish to consider remedies against third parties (who may be more readily identifiable). For example, if a third party comes into possession of fraudulently obtained virtual currency, and was not a purchaser for value, then a claim of knowing receipt, a proprietary restitutionary claim or a claim for unjust

enrichment may be available. However, if the third party was a bona fide purchaser for value these remedies will likely not be available.

Civil or criminal liability may arise if virtual currency providers do not comply with the requirements of the FMCA. Additionally, breaches of the key disclosure provisions of the FMCA may also give rise to automatic liability for directors (if identifiable) of virtual currency providers. The FMCA also imposes accessory civil liability on any person 'involved in a contravention' of the civil liability provisions.[10]

Tax

The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 implemented some targeted rules around the tax treatment of 'cryptocurrencies' (definition discussed below) under the financial arrangements in the Income Tax Act 2007 and the Goods and Services Tax Act 1985 (the GST Act). These amendments apply retrospectively from 1 January 2009. Outside of these specific rules, the taxation of virtual currencies is governed by the existing legal framework.

i Income tax

Broadly, a person may become subject to income tax on amounts derived from virtual currencies in circumstances where the amount is derived from:

1. a business of the person and is not a capital receipt;
2. carrying on or carrying out an undertaking or scheme entered into or devised for the purpose of making a profit; or
3. disposing of personal property of the person if the property was acquired with the purpose of disposing of it.

The New Zealand Inland Revenue (IRD) has issued guidance on the tax treatment of virtual currencies, in which it states that virtual currencies should be treated as personal property (not currency) for income tax purposes. A person acquiring virtual currency for the purpose of disposing of it will therefore be taxable on any gain under one of the principles summarised above.

In relation to provisions that refer to a person's purpose, it is the person's subjective dominant purpose at the time of acquiring the property that is relevant. Therefore, if, at the time of acquiring virtual currency, a person does so with the purpose of later disposing of it, any amounts derived from the disposal (e.g., for a sale or exchange) will be treated as income (and therefore be subject to income tax). The IRD's guidance suggests virtual currencies will generally be acquired with the purpose of sale or exchange because (in general) virtual currencies do not produce an income stream or any benefits, except when sold or exchanged. However, this guidance has been questioned by some commentators who have argued that an asset that does not produce an income stream or other benefit is not necessarily acquired for the dominant purpose of sale or exchange. Instead, it is a question of fact in each case, and each amount derived from disposing of virtual currencies

should be considered separately to determine whether the virtual currency was acquired for the purpose of disposal and whether the amounts derived from the disposal are income to which income tax will apply.

The IRD has also issued guidance concerning the tax treatment of cryptoassets provided to an employee in connection with the employee's employment. The guidance generally provides that the payment of remuneration to an employee in the form of cryptoassets will be subject to the same tax treatment as salary or wages or bonuses (as the case may be) that are paid in cash, where the cryptoassets being paid can be converted directly into a fiat currency (on an exchange) and either a significant purpose of the cryptoasset is to function like a currency or the value of the cryptoasset is pegged to one or more fiat currencies. Guidance has also been issued on other scenarios, in which the provision of cryptoassets to an employee in connection with the employee's employment may be taxable as a fringe benefit or under the employee share scheme rules.

New Zealand has a regime known as the 'financial arrangements rules'. These rules require a party to a 'financial arrangement' to spread income and expenditure over the term of the financial arrangement for tax purposes. The financial arrangements rules disregard the traditional distinction between capital and revenue, and instead have regard to all consideration paid or received under the financial arrangement.

Broadly, a financial arrangement is an arrangement under which a person receives money in consideration for that person, or another person, providing money to any person: at a future time; or on the occurrence or non-occurrence of a future event.

Cryptocurrencies are excepted financial arrangements and therefore expressly excluded from the financial arrangements rules. The policy reasoning behind this exclusion is that it is more appropriate and practical to tax cryptoassets at the time that they are sold or exchanged rather than on an accrual basis over the term of the cryptoasset, as would be the case if the financial arrangements rules applied. The term 'cryptocurrency' is defined as a cryptoasset (a digital representation of value that exists in a database that is secured cryptographically and contains ledgers, recording transactions and contracts involving digital representations of value, that are maintained in decentralised form and shared across different locations and persons; or another application of the same technology performing an equivalent function) that is not a non-fungible token. However, cryptocurrencies that provide specified returns are not included as excepted financial arrangements and may still be subject to the financial arrangements rules. This is because such cryptocurrencies are economically equivalent to debt arrangements that generally would be subject to the financial arrangements rules.

ii Goods and services tax

GST is imposed under the GST Act and is charged on supplies in New Zealand of goods and services by a registered person in the course or furtherance of a taxable activity.

A person makes supplies in the course or furtherance of a taxable activity if the supplies are in the course of an activity (whether or not for pecuniary profit) carried on continuously or regularly by the person involving the supply of goods and services for consideration. The term 'taxable activity' includes any activities carried on in the form of a business or trade.

Cryptocurrencies are excluded from the definition of 'goods' and 'services' under the GST Act and as a result, the supply of cryptocurrencies is expressly not subject to GST. This avoids several issues, including supplies to residents potentially being treated differently to non-residents (to which supplies could possibly be zero-rated and therefore create a distortion to supply virtual currencies to non-residents over residents), as well as any transaction involving the exchange of virtual currency for goods or services potentially being treated as a barter transaction. Brokerage and commissioning services for cryptocurrencies are also 'financial services' under the GST Act that are exempt from GST.

Outlook and conclusions

Public and regulator interest in virtual currencies continues to grow in New Zealand and globally. The FMA is the key regulator in New Zealand in respect of virtual currencies, and its position in respect of developments in this area has been clearly stated in the Guidance.

One of the purposes of the FMCA is to promote innovation and flexibility in the financial markets, and the FMA has stressed that its job is not to stop innovative businesses from succeeding. However, promoting innovation does not mean that the FMA will allow risks of new technology and products to be passed on to retail investors in a manner that investors do not understand. Accordingly, the FMA's position is that open and early communication is vital for persons seeking to launch blockchain-related products and technology in New Zealand.

In July 2021, the Finance and Expenditure Committee of New Zealand's House of Representatives (Committee) launched an inquiry into the current and future nature, impact and risks of cryptocurrencies, and is likely to report to Parliament on the inquiry.-[11] However, it is unclear when the Committee will do so, and the regulatory outcomes of the inquiry are as yet uncertain. The pending outcome from this inquiry foreshadows the possibility of more specific regulation for virtual currencies in New Zealand.

In September 2021, the RBNZ also initiated a comprehensive public consultation entitled 'The Future of Money', which included consultation on the possible issuance by the RBNZ of a central bank digital currency. A significant amount of work is still to be carried out on policy development, and thus it remains unclear whether a central bank digital currency will proceed in New Zealand.

In June 2023, the RBNZ released their summary of submissions relating to virtual currencies. The RBNZ considered that widespread regulation of the virtual asset industry was still not warranted, citing a desire for consistency with current international regulatory approaches. A time frame of beyond 18 months was presented for when the RBNZ would reassess this stance.

Cryptopia

In January 2019, Cryptopia (an international cryptocurrency exchange based in New Zealand) suffered a major security breach, with approximately NZ$30 million of

cryptocurrency reportedly stolen.[12] At its height, Cryptopia had peak daily trading volumes greater than the New Zealand Stock Exchange.

Cryptopia was placed into liquidation following the hack. Liquidation proceedings have been complex owing to the lack of legal precedent on the treatment of cryptoassets in a liquidation. On the application of the liquidators for guidance, the High Court readily found in Ruscoe v. Cryptopia that cryptocurrency was 'property' for the purpose of the Companies Act 1993 and 'also probably more generally',[13] and that there was sufficient evidence to establish that Cryptopia held the stolen cryptoassets on trust for its various account holders. While Ruscoe has not yet been appealed, the High Court decision is an important milestone in cryptocurrencies' legal evolution in New Zealand. The recognition of cryptoassets as property opens up as yet untested possibilities, such as the use of cryptoassets as security for borrowing.

The liquidators launched a claims process in December 2020 to qualifying users, after reconciling more than 900,000 customer accounts across approximately 500 different cryptocurrencies.[14] The security breach is the subject of an ongoing police and digital forensic investigation. The Cryptopia hack serves as a timely reminder for cryptocurrency exchanges and other entities handling customers' money of the importance of having robust security arrangements in place.

Endnotes

1 https://fma.govt.nz/business/services/cryptocurrencies. Back to section

2 https://www.fma.govt.nz/compliance/role/cryptocurrencies/ at 'Client money or property service (including a custodial service)'. Back to section

3 ibid. Back to section

4 ibid. Back to section

5 https://www.fma.govt.nz/compliance/role/cryptocurrencies/ at 'ICOs and financial services'. Back to section

6 https://www.dia.govt.nz/AML-CFT-Virtual-Asset-Service-Providers. Back to section

7 ibid. Back to section

8 https://www.dia.govt.nz/Information-for-Virtual-Asset-Service-Providers, p. 5. Back to section

9 https://www.fma.govt.nz/news-and-resources/media-releases/amlcft-risk-ratings-confirmed-for-sectors-under-fma-supervision/. Back to section

10 FMCA Sections 486–489, 497, 533. Back to section

11 https://www.parliament.nz/en/pb/sc/make-a-submission/document/53SCFE_SCF_INQ_111968/inquiry-into-the-current-and-future-nature-impact. Back to section

12 Ruscoe v. Cryptopia (in liquidation) [2020] NZHC 728 at [38]. Back to section

13 ibid. at [133]. Back to section

14 https://www.grantthornton.co.nz/globalassets/1.-member-firms/new-zealand/pdfs/sixth-liquidators-report_cryptopia-new.pdf. Back to section

Tom Hunt tom.hunt@russellmcveagh.com
Fred Ward fred.ward@russellmcveagh.com

Russell McVeagh