Blockchain Technology and Cryptocurrencies in a Nutshell

The blockchain technology came to the world's attention with the article of Satoshi Nakamoto in 2009. While the people behind this name is still unknown, the paper itself caused much attention and a whole new economy is built based on the futuristic aspects set forth by the article. In its article Nakamoto offered a system of trust with the help of blockchain infrastructure, where the parties involved in a transaction have no longer the need to trust a third party such as banks and public institutions.

While blockchain technology touches upon number of fields and this number continues to grow, this article aims to discover the effects of the technology in monetary transactions. Therefore the following sections will aim to shed light to the legal spectrum around the cryptocurrencies under Turkish Law.

Cryptocurrencies rely on the blockchain network(s). With Bitcoin, for example, once a transaction is confirmed, it is added to the blockchain so that the balance of an account (called wallets in Bitcoin) can be calculated. A transaction in bitcoin may be defined as a transfer of value between bitcoin wallets. Every bitcoin wallet has two types of “keys”, public and private keys. To ensure the system's anonymity, the wallets in the Bitcoin system do not utilize the account owners' names or identifiable information. Public keys allow the wallet owner to share their public key with anyone wishing to enter into a transaction with them. In contrast, only the wallet owner knows their private key, which enables the wallet owner to access their wallet and initiate/sign transactions. This signature provides a mathematical proof of the account owner and prevents other parties from altering the transaction once it has been issued. Once the foregoing procedure finalizes, transactions are confirmed and included to the blockchain through a process called mining.

Current Status and Legislation Initiatives

1. Existing Laws

The main piece of legislation in Turkey on e-money is the Law on Payment and Securities Settlement Systems, Payment Services and Electronic Money Institutions No. 6493 (the “Payment Services Law”). Under the Payment Services Law, e-money is defined as monetary value (i) issued by an e-money issuer in return for the funds deposited to such e-money issuer, (ii) maintained electronically, (iii) used for payment purposes, (iv) accepted as a payment instrument by persons other than the e-money issuer. As cryptocurrencies are not issued in return for funds deposited with the issuer, they do not qualify as e-money under Turkish law. Accordingly, they are not subject to oversight by the BRSA, the banking regulator.

As explained in Nakamoto's initial paper, Bitcoin refuses to be issued in return for funds deposited. As the whole system relies on independence from any other fund, it is unlikely that there will be any incentive to overcome the issue of not qualifying as e-money. In addition, Bitcoin has other issues regarding the e-money definition. For instance, there is no authority in charge of the issuance of bitcoins: basically anyone with enough computing power may conduct “mining” activities and earn bitcoins, and therefore introduce new bitcoins into the system.

The BRSA emphasized this point in its opinion on Bitcoin in 2013. The BRSA expressed that Bitcoin does not qualify as e-money and does not fall into the scope of the Payment Services Law since it is not issued by an official authority or a private institution and its consideration is not assured. Therefore, it is not subject to the BRSA's supervision or oversight. Furthermore, the BRSA warned the investors that cryptocurrencies may pose certain risks since (i) their valuation could be extremely volatile, (ii) digital wallets could be lost or stolen and (iii) digital wallet providers and traders could abuse the cryptocurrencies and investors. Consequently, cryptocurrency exchange transactions would be beyond the BRSA’s oversight and the investors are deprived from regulatory protection against potential risks.

The Capital Markets Board of Turkey (the “CMB”), the capital markets regulator, also published a research report on Bitcoin, with analysis on cryptocurrencies and blockchain technology in December 2016. Further, with respect to cryptocurrencies' status under Turkish capital markets regulations, on December 1, 2017, the CMB issued a letter to the Capital Markets Association of Turkey stating that (i) cryptocurrencies are not specifically regulated under Turkish law and (ii) considering that cryptocurrencies are not regulated as one of the items which derivatives can be based on under the Capital Markets Law No. 6362 (the “CML”), Turkish investment institutions must not engage in any spot or derivatives transactions based on cryptocurrencies.
Apart from the cryptocurrencies, blockchain system also enabled another incentive regarding the funding activities. This incentive is called an initial coin offering (the “ICO”). An initial coin offering is a way of funding with the help of “smart contracts” working on blockchain system. Simply ICO is an “open call, through the Internet, for the provision of cryptocurrencies in exchange for tokens generated through smart contacts and relying on the blockchain technology, allowing the pledger to enjoy an exclusive right or reward or financial claim”.

In its bulletin dated September 27, 2018, the CMB reiterated that ICOs are mostly out of the scope of the CMB’s regulation and supervision. The CMB also warned the investors about ICOs, stating they are highly risky and speculative investments and the investors may lose the entirety of their original investment. The CMB also indicated similar to SEC’s declaration on the matter that, in certain cases, ICOs may have similar aspects to public offering of securities (“Public Offering”) and crowdfunding that could turn them into a regulated activity, depending on their characteristics. In case an ICO is considered a Public Offering or crowdfunding activity, it would require regulatory approval and certain level of disclosure. Therefore, unless an ICO constitutes a Public Offering or crowdfunding, it would be beyond the regulator’s oversight and the investors would be deprived of regulatory protection against potential risks, as stated in the CMB’s bulletin.

The Financial Crimes Investigation Board (“MASAK”) also stated that the transactions involving money transfers to purchase Bitcoin are considered a suspicious transaction that must be reported to MASAK. MASAK primarily adopted this approach because the parties to a transaction made with cryptocurrencies cannot be identified and thus, cryptocurrencies may be used in illegal activities.

2. Recent Developments

Turkey’s 11th Development Plan (the “Development Plan”) published on July 23, 2019 introduced new strategies for Turkish financial markets. One of the main objectives of these strategies is to create a financial sector with strong institutional structure, and for Istanbul to become an attractive global financial center. In this respect, the Development Plan foresees the establishment of a finance and technology centre (i.e., Istanbul Finans ve Teknoloji Üssü) in Istanbul.

The Development Plan also introduces blockchain strategies to achieve the abovementioned goal. These strategies are (i) implementing a digital central bank money based on blockchain; (ii) the completion of necessary legal and physical infrastructure for services relating to transportation and customs to extend the scope of the blockchain practice; and (iii) improving process and technical infrastructure in order to benefit from new technologies, such as blockchain, cloud computing, and artificial intelligence to improve public services.

Based on the strategies introduced in the Development Plan, Turkey’s approach to blockchain and cryptocurrencies has evolved into a more favourable environment. Accordingly, the CMB announced that they are working on regulations on digital assets. As a follow-up, the long awaited Crowdfunding Communiqué entered into force on October 3, 2019 and introduced rules and procedures regarding crowdfunding platforms, the operations of the platforms, the membership and campaign process of these platforms, and the use of funds and venture capital companies.

The Financial Stability Committee (composed of the Minister of Treasury and Finance and the chairpersons of the Central Bank of Turkey, the BRSİ, the CMB and the Saving Deposit Insurance Fund) also announced that they are evaluating the benefits of new financial technologies and a working group will be established to develop regulations on cryptocurrencies.

**Taxation of Digital Assets in Turkey**

The Turkish tax legislation does not include any specific provision regarding the taxation of income derived from digital assets such as cryptocurrencies and there are no Turkish Tax Administration rulings or court decisions regarding this matter. Therefore, there is uncertainty regarding the taxation of these assets stemming from the fact that there is no consensus regarding their legal status vis-à-vis the tax legislation. In line with the above explanations, the probable answer to the question of whether cryptocurrencies should be considered “money”, “securities” or “commodity” for taxation purposes would be “commodity”.

In a scenario where cryptocurrency is considered a “commodity” and real persons are engaged in transactions such as sale, transfer and barter of cryptocurrencies at the level, volume and continuity to be considered a commercial activity, the income derived from this commodity (digital asset) trade will be subject to income tax as commercial income in line with Article 37 of the Income Tax Law. For VAT purposes, since cryptocurrency transactions are carried out online, there may be certain issues regarding whether the condition of “delivery in Turkey” is met, as well as issues regarding documentation. However, the Turkish Tax Administration may claim that 18% VAT should be calculated on invoices issued by real persons continuously engaged in cryptocurrency activities. If real persons are engaged in the sale of cryptocurrency at a level that is not considered commercial activity within the scope of Article 37 of the Income Tax Law, the income derived from this activity should be considered casual income within the scope of Article 82 of the Income Tax Law. Casual income does not fall within the scope of VAT as it does not meet the continuity condition required by Article 1 of the VAT Law.

If an entity generates income from the sale of cryptocurrency, the income will be considered a commercial activity and therefore subject to corporate income tax. In addition, 18% VAT will be calculated on the cryptocurrency sale invoices.

As intermediary activities to cryptocurrency mining and cryptocurrency transactions require a continuous capital allocation and organization, the income generated from these activities will be subject to (i) income tax within the scope commercial activity provisions for real persons and (ii) corporate income tax for entities. In addition, invoices issued will be subject to 18% VAT.

Documents issued and signed (including e-signatures) in connection with cryptocurrency transactions will be subject to 0.948% stamp tax.
Conclusion

As the regulators of the financial industry conceded, cryptocurrencies are not specifically regulated under Turkish law and they are broadly beyond the scope of regulatory overview, posing transaction security risks. Turkish financial regulators are currently leading initiatives to regulate these digital assets in a manner compatible with the laws regulating conventional financial products. The strategies regarding blockchain technology and cryptocurrencies foreseen in the Development Plan constitute a positive indicator with respect to Turkey’s willingness to become one of the market leaders for these new technologies.

The fact that cryptocurrencies are not specifically regulated under Turkish law creates uncertainty for taxation of these assets. Therefore, when the necessary regulations are adopted, we expect that the Turkish Tax Administration will take the necessary steps to eliminate those uncertainties.

Footnotes

2 Ibid, p.2-3
3 Ibid, p.3
4 “Mining is a distributed consensus system that is used to confirm pending transactions by including them in the block chain. It enforces a chronological order in the block chain, protects the neutrality of the network, and allows different computers to agree on the state of the system. To be confirmed, transactions must be packed in a block that fits very strict cryptographic rules that will be verified by the network. These rules prevent previous blocks from being modified because doing so would invalidate all the subsequent blocks. Mining also creates the equivalent of a competitive lottery that prevents any individual from easily adding new blocks consecutively to the block chain. In this way, no group or individuals can control what is included in the block chain or replace parts of the block chain to roll back their own spends.” www.bitcoin.org
6 https://www.sec.gov/ICO, last accessed on October 18, 2019.
7 Crowdfunding is defined as collecting funds from the public through crowdfunding platforms to fund a project or a company. The activities falling within this definition are not considered a public offering and those who collect funds through crowdfunding platforms are not considered issuers. Crowdfunding platforms are “entities that intermediate crowdfunding and operate electronically”. Crowdfunding platforms are licensed by the CMB and they are entitled to collect funds without preparing any offering circulars.

The establishment and operation of crowdfunding platforms are subject to the CMB’s approval. The CMB recently determined the rules and procedures applicable to establishment, shareholders, share transfers, employees, and the maximum funding limits for one individual and fund collection for one project or company, operations, monitoring, and supervision. Please see our alert for the details of new crowdfunding rules.