

LCQ20: Regulation of virtual asset investment activities

Following is a question by the Hon Wu Chi-wai and a written reply by the Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (April 3):

Question:

It is learnt that following the rapid development of virtual asset-related investment activities in recent years, incidents of investors incurring losses have occurred frequently. For instances, the Court has recently ordered the winding up of a virtual currency exchange, and the Police have earlier arrested a person for allegedly having enticed investors by fraudulent means into buying mining devices purportedly for mining virtual currency. On the other hand, the Securities and Futures Commission (SFC) announced in November last year a new regulatory approach for virtual assets, aiming to bring virtual asset portfolio managers and distributors of virtual asset funds into SFC's regulatory net. In this connection, will the Government inform this Council:

(1) of the details of the law enforcement actions taken in the past three years by various law enforcement agencies on suspected cases of (a) using virtual currencies for money laundering, (b) enticing investors into buying mining devices by fraudulent means, and (c) soliciting investments in virtual assets by unlawful means, including (i) the amount of money involved, (ii) the respective numbers of persons arrested, prosecuted and convicted, and (iii) the penalties imposed on those convicted;

(2) whether the sale of virtual asset-related commodities (such as mining devices) falls within the ambit of the Trade Descriptions Ordinance (Cap. 362); if not, of the reasons for that, and whether the Government will amend the legislation to bring it into the ambit by the Customs and Excise Department;

(3) whether individuals or business operators are currently required to pay taxes for transactions (such as trading of properties or funds) conducted using virtual currencies; if so, how the Inland Revenue Department (IRD) ensures that the secrecy associated with transactions of virtual currencies will not lead to a reduction in tax revenue;

(4) of the respective amounts of profits taxes collected in each of the past three years by the IRD on the operation of (i) virtual assets trading platforms, (ii) the sale of mining devices, (iii) cloud mining, (iv) smart vending machines equipped with virtual currency-related functions, and (v) other virtual asset-related commercial activities;

(5) whether the IRD initiated investigations in the past three years into

cases of suspected tax evasion regarding the operation of virtual asset-related businesses; if so, of the respective numbers of investigations, prosecutions and convictions, and the penalties imposed on those convicted; of the number of cases in which the offenders paid fines in lieu of being prosecuted, and the average amount of fines paid by them; and

(6) whether the SFC, the Hong Kong Monetary Authority and the relevant government departments will study the stepping up of the regulation of virtual asset-related investment activities; if so, of the details?

Reply:

President,

In consultation with relevant bureaux, departments and financial regulators, we have prepared a consolidated reply to the Hon Wu Chi-wai's question as follows:

(1) The Police have spared no effort in combating money laundering activities and have been closely monitoring the crime trend relating to virtual assets. In recent years, crimes relating to virtual assets have been on the rise, mainly involving deception and blackmail. In 2018, there were 324 cases of virtual assets-related crimes reported to the Police, while in 2016 and 2017, there were 67 and 50 cases of Bitcoin-related cases reported respectively (the Police only maintained figures relating to Bitcoin in the concerned period).

As for investment fraud cases, between 2016 and 2018, the number of cases received by the Police each year was 134, 137 and 212 respectively. Fraudsters made use of different kinds of investment products to lure victims with claims of high returns and low risks. The Police targeted these investment fraud cases with multiple intelligence-led enforcement operations. For instance, early this year the Police arrested three persons suspected of deceiving over 20 victims to invest in virtual assets-related computer equipment and services, with the investments amounting to HK\$3.7 million.

As for the Securities and Futures Commission (SFC), it has issued press statements in respect of regulatory actions taken in respect of activities involving cryptocurrencies. SFC issued a press release in February 2018 noting that it had taken regulatory actions against seven cryptocurrency exchanges and seven issuers of initial coin offerings (ICOs) to warn them of the implications for conducting activities involving cryptocurrencies which were "securities" as defined in the Securities and Futures Ordinance (SFO) without a licence. SFC issued another press release in March 2018, noting that it took regulatory actions against an ICO issuer, which resulted in the halting of its ICO to the Hong Kong public over concerns that the company had engaged in potential unauthorised promotional activities and unlicensed regulated activities.

(2) Regarding the sale of mining machines or other products related to virtual assets, a trader who, in the course of business, engages in unfair

trade practices prohibited under the Trade Descriptions Ordinance (TDO), including "false trade descriptions", "misleading omissions", "aggressive commercial practices", "bait advertising", "bait-and-switch", and "wrongly accepting payment", commits an offence. A maximum fine of \$500,000 and imprisonment for five years may be imposed upon conviction.

The Customs and Excise Department strives to combat unfair trade practices that contravene the TDO. It closely observes and monitors relevant situations in the market. If contravention of the TDO is found, appropriate actions will be taken immediately to protect consumer interests.

(3), (4) and (5) Under the Inland Revenue Ordinance (IRO), except for profits from the sale of capital assets, profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong are chargeable to profits tax. Whether certain profits or gains in a particular case are chargeable to profits tax has to be considered on the basis of its own individual facts and circumstances. The provisions concerning profits tax in the IRO and the relevant case law are equally applicable to transactions involving virtual assets.

The Inland Revenue Department (IRD) is committed to maintaining the integrity of Hong Kong's taxation system. It collects information from various channels, supplemented by information technology. Cases are selected for audits and in-depth investigations as appropriate based on risk assessment. If necessary, the IRD will also seek relevant information from other tax authorities through the exchange of information mechanism under tax treaties so as to enhance its capability of detecting tax avoidance and evasion. IRD does not maintain statistics specifically on tax payable by persons carrying on virtual asset-related activities and relevant investigation cases.

(6) As the development of virtual assets trading is evolving rapidly, the Financial Services and the Treasury Bureau (FSTB) and the SFC have been monitoring the international regulatory development closely in order to explore whether it is appropriate to put virtual assets trading platforms under regulation. In November 2018, the SFC announced an exploratory regulatory approach under the sandbox environment to explore whether it was suitable to license and regulate virtual assets platforms using its existing power. SFC would decide whether, and if so, how to regulate virtual assets trading platforms after the exploratory stage. SFC is currently in discussion with some virtual assets trading platform operators so as to understand more about their operations, with a view to determining whether virtual assets trading platforms should be regulated under the SFO.

FSTB and financial regulators will continue to keep in view the development of virtual assets activities locally and globally. SFC will also continue to review its existing measures and suitably consider whether or not to put in place a more effective regulatory approach. We will maintain contact with overseas regulators through participation in relevant international organisations, including the International Organisation of Securities Commissions and the Financial Stability Board, to ensure that we

can devise a suitable mechanism in good time to address the potential risks arising from virtual assets activities.