



**INTERNATIONAL  
FINANCE CENTRE  
DEVELOPMENT AGENCY**

# The Legal Status of Blockchain Commerce in the Kyrgyz Republic

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This report was commissioned by the International Finance Centre Development Agency and written by the legal teams of John Tiner & Partners (Geneva) and John Tiner & Partners Eurasia (Bishkek).

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John Tiner & Partners ([www.tiner.ch](http://www.tiner.ch)) is a Geneva-headquartered international firm established in 1995 by the US and ex-USSR lawyers to focus on the business in the countries of the former Soviet Union.

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## **A brief introduction to the Kyrgyz Republic**

**The Kyrgyz Republic** (also known as **Kyrgyzstan**, or *Kirgizia*, in Soviet-speak) is a landlocked high altitude country sandwiched between Kazakhstan in the north and China in the south and bordering Uzbekistan and Tajikistan in the west. It is approximately 5 times the size of Switzerland and has a population of ~ 6 million people. Kyrgyz and Russian languages are both official - a legacy of the USSR which built this country's industry and created a large class of educated people.

Kyrgyzstan has become a comfortable regional and international investment hub whose predictability and stability are times higher than in the neighbouring countries, whose laws are the most liberal among the post-Soviet nations and whose service infrastructure for finance and investment is durable and inexpensive.

The Kyrgyz Republic is a real parliamentary democracy with a very balanced Constitution built on the anti-authoritarian traditions of the Kyrgyz people. The local tribal and nomadic traditions support the communal, consensus-based decision-making and make any dictatorial tendencies unacceptable to the society. In the past the leaders who attempted to usurp absolute power were more or less quickly ousted by popular dissent.

Now Kyrgyzstan enjoys political stability, truly democratic elections (there are 6 political parties in the Parliament and neither has a majority; the 15<sup>th</sup> October 2017 presidential elections were a contest between 13 candidates, and the result was impossible to predict till the official count was completed).

The Kyrgyz Republic is a member of the WTO and at the same time party to the Customs Union with Kazakhstan, Russia, Armenia and Belarus. The government, although somewhat reliant on international support in the form of loans (major lenders

are China, the World Bank and Russia), tries to maintain a balanced and neutral foreign policy.

Kyrgyz Som, the local currency, is relatively stable and is supported by foreign exchange reserves of the National Bank which have been growing for many consecutive years. The country enjoys a healthy inflow of hard currency from the sales of the produce of its active mining industry and from the inbound remittances by migrant workers. There are 24 banks in the country, and many have notable first-class international founders. Most enjoy excellent correspondent relations with clearing banks. The banking system in the country is open for use by non-residents.

Bishkek, the capital of Kyrgyzstan, home to over a million people, is a thriving cosmopolitan centre, with much modern residential and office construction going on and new restaurants and high quality shops opening every week.

Kyrgyzstan has a combination of low taxes and a set of very liberal laws governing foreign investment and capital flows.

Companies and individuals pay a 10% Income (Profit) tax; there is an abundance of tax rebates and zero rate provisions (such as for startup industrial production having achieved a certain turnover, software developers, leasing companies, agricultural firms etc.) Gold mining companies pay a small turnover tax and do not have their profits taxed.

Kyrgyzstan has no capital flow (exchange) controls or restrictions: any capital or profits may be brought into the country and paid out at will. Kyrgyz residents are free to bank anywhere in the world, buy and sell foreign currency and gold and expatriate it at any time. There are practically no restrictions on transactions with physical gold.

Since the early 1990s the Kyrgyz law contains unique provisions maintaining the "Investor is always right" regime. If a matter, such as an application for a mining lease or approval of the exploration report, is dragged by the State officials for longer than is set in the law, the application is deemed approved as filed, without reservation. This is unique for the region otherwise known for its intricate post-Soviet bureaucracy.

Many activities which are subject to licensing elsewhere in the region can be undertaken in Kyrgyzstan without a license, subject only to observance of the legal regulations. It is the result of gradual reduction of the administrative burden on the economy diligently pursued by Kyrgyzstan for the past 15 years with the help of international financial consultants.

## **Blockchain: a hot topic**

We are witnessing now the explosive growth of interest in businesses based on the blockchain technology.

Since this technology is highly innovative, it is sometimes unclear how various phenomena introduced by its development correlate with existing legislation. Opinions differ: from the purely 'anarchist' view that all crypto-commerce is beyond modern law to the 'bureaucratic' standpoint that each technological phenomenon must be separately regulated by specialized legislation.

Kyrgyzstan is no stranger to supporting innovative technologies. It is now developing an ambitious electronic government program ('Taza Koom'), in 2011 it established a hub for zero-tax internet commerce called The High Technologies Park and has recently announced plans to use blockchain to ensure corruption-free Government procurement.

This report was commissioned to remove legal uncertainty potentially pertaining to the status of various blockchain-related phenomena under Kyrgyz law and thus to pave the way for the development of blockchain commerce in the Kyrgyz Republic.

The findings of the report were presented to the Government of the Kyrgyz Republic in early March 2018 and were debated and commented upon by all the State authorities whose regulatory outreach potentially touches the blockchain commerce. This report is being published following its successful presentation and discussion with the regulatory authorities.

## **Conclusion of this report in brief**

The legislation of the Kyrgyz Republic neither prohibits nor obstructs transactions with blockchain assets (crypto-assets). Trading crypto-assets, raising finance through crypto-assets and crypto-asset mining are legal but subject to local tax law, anti-money laundering legislation and the national standards for the protection of investors and consumers, inasmuch as they are applicable to other lawful ordinary commerce. Neither of the regulations is cumbersome for a good faith business.

Moreover, the uniqueness of the Kyrgyz legislation is that it now provides an opportunity to develop international-scale projects based on blockchain without the need for any additional legislation to be adopted. Thus, Kyrgyzstan can now satisfy the demand of international hi-tech investors to operate in a blockchain-friendly regulated jurisdiction.

## **Blockchain in (very) simple words**

**Blockchain (block chain)** is a cryptography-based technology used primarily on the internet, which allows to store information on past transactions on a distributed ledger over a network in a modification-resistant manner. The information is stored in a series of records called blocks which are linked and secured using cryptography. Each block typically contains a cryptographic hash of the previous block. Once recorded, the data in any given block cannot be altered retroactively without the alteration of all subsequent blocks, which requires collusion of the network majority.

The first work on a cryptographically secured chain of blocks was described in 1991 by Stuart Haber and W. Scott Stornetta; the technology as we know it now was conceptualized in 2008 and then implemented as a core component of a cryptocurrency bitcoin.

A direct consequence of this technology's development is the possibility not only to create cryptography-protected distributed registers on the internet, but also to use the records in these registers as consensual units of value, trade them, use them as negotiable value (means of payment) and create self-executable contracts on their basis.

The first of such blockchain technology-based units was bitcoin. Presently there are tens of thousands of such cryptographic units in existence over the internet, some of which are used in settlements (so called, cryptocurrencies). Others were created to guarantee their holders certain investment rights or access to goods and services (so called, crypto-tokens).

A number of above-described cryptographic units have recently become a popular object for investment, mainly in the hope that they may be resold in the future for a higher price. Several cryptocurrencies - first of all, Bitcoin and Ether have become popular settlement units for goods and services, in the internet and beyond.

## **Phenomena created by the blockchain technology (defined for easy understanding by non-techies)**

**"cryptocurrency"** - cryptographically protected records in a distributed register (ledger) existing on the internet, which are primarily used as a means of settlement. The most popular units are: bitcoin (Bitcoin blockchain), ether (Ethereum), litecoin (Litecoin), Rippl, Dash (Digital Cash), IOTA (Internet Of Things). The only objective value of the majority of cryptocurrencies is their utility for settlements over the internet, although a number of cryptocurrencies exist which imply being backed by real (fiat) currency or tangible assets, such as gold.

**"token"** - a programmable unit in the distributed ledger based on the blockchain technology which typically represent an asset or a utility. Tokens may be created to carry various rights, such as participation in the profits of the issuing company (similar to shares), or the right to obtain a good or a service (for example, a certain volume of disk space in a cloud storage). It is customary to distinguish investment tokens (functional analogy of shares) and utility tokens - analogous to contracts to supply a good or a service. It is also possible to create tokens linked to a specific value in the material world (Eg. a security or a fiat currency). Tokens can be issued by a single issuer, or in a decentralized way (managed by an algorithm). The term 'token' can overlap with the definition of cryptocurrencies; no universally agreed distinction between the two exist.

**"mining"** - performance of computations supporting the functioning of the distributed register (ledger) based on blockchain. Complex computations are required to create and encrypt a record of a transaction within a particular blockchain so that it is then safely stored on the entire blockchain (Eg. a record of certain number of crypto-units being

transferred from one account to the other). The functioning of a blockchain system is not possible without 'mining'. As a pre-determined reward for exploiting the productive capacity of one's computer, the 'miner' obtains a certain number of the cryptographic units whose blockchain system he/she supported by making computations.

"**ICO**" (Initial Coin Offering) - by analogy with the term *IPO* (initial public offering of securities), ICO means the raising of money and cryptocurrencies from the general public in return for distributing cryptographic tokens. Such tokens may entitle the holder to receive either a share of revenue of the issuing company (similar to shares) or to claim a good, a service, or some other benefit.

In this report we will use the term '**crypto-assets**' as the common name for a great variety of blockchain-recorded cryptographic units<sup>1</sup>. It is a technically neutral definition, and it implies that all such units have or are considered to have, a certain value.

## **Legal status of crypto-assets in the Kyrgyz Republic**

**Are crypto-assets recognized as 'objects of rights and obligations' in the Kyrgyz Republic<sup>2</sup>?**

- Yes, they are.

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<sup>1</sup> We note that in the very recent G20 Communique following the G20 summit (meeting of Finance Ministers and Central Bank Governors) in Buenos Aires on 19-20 March 2018, such units are called "crypto-assets".

<sup>2</sup> A note for legal geeks. Kyrgyzstan follows the legal pattern of the USSR in that it is a "Civil Law" country. Certain terms originating in the UK or the US (which are Common Law countries) may not have an adequate equivalent in the Kyrgyz Republic, and vice versa. The authors of the report tried to make it as easy to understand as possible and therefore we will sometimes use cross-jurisdictional equivalents to the original legal terms of the Kyrgyz legal system, for ease of explanation.

The Civil Code of the Kyrgyz Republic provides a list of objects of civil rights and obligations which is not exhaustive and includes any "things" (*res*) and other "material and immaterial values":

Civil Code, Article 22. Types of civil rights objects

Objects of civil rights include things (*res*), including money and securities, other property, including property rights; works and services; protected information, results of intellectual activity and equivalent means of individualization (intellectual property), as well as other material [tangible] and non-material [intangible] values.

### **What is a more precise qualification of crypto-assets under Kyrgyz law?**

- Crypto-assets fall within the category of "movable things" (*res mobiles*).

Civil Code of the Kyrgyz Republic, Article 24 "Immovable and Movable Things"

1. Immovable things (realty, immovable property) are plots of land, underground resources, separated water objects and anything which is firmly connected to land, meaning objects which can not be moved without causing a disproportionate damage to their intended use, including forests, perennial plants, buildings, constructions etc.

The law of the Kyrgyz Republic may attribute other property to immovable things.

2. Title and other proprietary rights to immovable things, limitations on such rights, their creation, transfer and termination shall be subject to State registration in a unified State register.

3. Things which are not attributed to immovable property, including money and securities, are recognized as movable property. Registration of rights to movable things is not required, unless otherwise provided by this Code or by law.

## **Are there any limitations on transactions with crypto-assets?**

- In the Kyrgyz Republic transactions with crypto-assets are not restricted because the law does not contain any specific indication to the contrary, and in the absence of a direct limitation, the law provides that:

The Civil Code of the Kyrgyz Republic

Article 23. Objects of civil rights in their civil circulation (turnover)<sup>3</sup>

1. Objects of civil rights can be freely alienated or transferred from one person to another as a matter of universal succession (inheritance, legal entity reorganization) or by any other means, unless the legislation removes them from the civil circulation or limits their civil circulation.

2. Types of civil rights objects which may not be in civil circulation (objects removed from civil circulation), must be directly named in law.

Types of the objects of civil rights which may be owned only by specifically determined participants of the civil turnover, or the circulation of which is allowed only by special permission (objects with limited circulation), are determined by a procedure established by law.

## **Are crypto-assets securities?**

- No, they are not.

In order for an instrument to be classified as a security under Kyrgyz law, it must be a 'document' or 'a method of fixing rights *which is provided by law*' (Civil Code, Article

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<sup>3</sup> 'Civil circulation' or 'civil turnover' are clumsy post-Soviet terms meaning 'commerce' or 'transactions'.

37, paragraph 1)<sup>4</sup>. Consequently, the crypto-assets we know now are not securities under the law of Kyrgyzstan.

Moreover, Kyrgyz law strictly supports the position that all the requisites of, and the requirements for, securities must be provided by law, and as a consequence, one may not give the status of a security to any asset whose characteristics are not defined in law as such of a security.

The Civil Code of the Kyrgyz Republic, Article 37, paragraph 2.

Types of rights which are certified by securities, mandatory requisites of securities, requirements as to the form of securities and other necessary requirements are determined by the law of the Kyrgyz Republic or in the manner provided by the law.

The absence of mandatory requisites of a security or non-conformity of a security to the form provided for it makes such security void.

Article 38. Kinds of securities

Securities are: bonds, promissory notes, cheques, bank certificates, bills of lading, shares and other documents which by law or by a procedure established by law are attributed to securities.

Finally, the Kyrgyz law regards as a security only such an instrument which has an obliged person. Each instrument recognized as a security under Kyrgyz law has an obligor - shares, bonds, bills of lading etc. Note that some of the crypto-assets do not have an obligor (bitcoin or ether, for example).

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<sup>4</sup> Note the difference with the regulation of this issue in the United States, where the definition of a security is an open one, and a particular type of security need not be specifically named in law to be classified as such.

## Using crypto-assets as a means of payment

In accordance with Article 31 of the Kyrgyz Republic Law of 16 December 2016 No 206 "On the National Bank of the Kyrgyz Republic, Banks and Banking", the only lawful means of payment on the territory of the Kyrgyz Republic is its national currency, the Som:

Law of the Kyrgyz Republic of 16 December 2016 No 206 "On the National Bank of the Kyrgyz Republic, Banks and Banking"

### **Article 31. Means of Payment**

1. Som is the only lawful means of payment on all the territory of the Kyrgyz Republic, which must be accepted without any limitation for all types of payments. On the territory of the Kyrgyz Republic all settlements and payments must be made in the national currency of the Kyrgyz Republic, unless the legislation of the Kyrgyz Republic provides otherwise. Prices for goods and services must be in soms, except in the contracts for goods or services exported or imported, where the currency of payment is determined by agreement of the parties.

Consequently, the use of any other currency or asset as a means of payment when settlement is made within Kyrgyzstan, will violate the law.

In relation to cryptocurrencies this position was reinforced by an advisory letter of the National Bank of the Kyrgyz Republic of 15 July 2014:

A Warning by the National Bank of the Kyrgyz Republic against the Distribution and Use of "Virtual Currencies", and in particular Bitcoin (15 July 2014)

"... one should not forget that in accordance with the legislation of the Kyrgyz Republic the only lawful payment means on the territory of our country is the national currency of Kyrgyzstan - the Som. And the use of "virtual currencies", and in particular bitcoins as a means of payment on the territory of the Kyrgyz Republic will be a violation of the legislation of our country".

From the legal standpoint one should differentiate the use of a crypto-asset as a means of payment and its barter for another asset. The use of it as a means of payment presumes the conclusion of a transaction aimed at the acquisition of a good or a service where the price of the transaction is fixed in a certain currency and this currency is paid under the transaction. Such a situation arises when the seller wants to sell his goods for a certain number of bitcoins and expects to receive them in the course of the transaction.

At the same time, the barter (exchange) of one crypto-asset for another, or for a 'real world' asset is not in itself the use of the crypto-asset as a means of payment. By analogy, the barter of an apartment for a car does not mean that the car was used in this transaction as a means of payment.

An important point is that it is forbidden to quote prices in any other currency (including a cryptocurrency) other than the Kyrgyz Som *on the territory of the Kyrgyz Republic*. This limitation does not extend to transactions which happen outside of Kyrgyzstan or transcend its borders (which happens when one of the parties is outside). For example, it is legal to set the price of exported goods in any currency.

## Can crypto-assets be categorized as 'currency values'<sup>5</sup>?

In accordance with the Civil Code of the Kyrgyz Republic, the types of property which are recognized as 'currency values', must be defined by the law on currency regulation (more commonly known as the law on exchange controls):

The Civil Code of the Kyrgyz Republic, Article 36 - Currency Values

The kinds of property which are considered to be currency values and the regulations on transactions with them on the territory of the Kyrgyz Republic are defined by the law on the currency regulation.

The right of ownership of the currency values in the Kyrgyz Republic shall be protected on common terms [with other kinds of property].

The Kyrgyz Republic Law No 6-I "On Transactions in Foreign Currency" contained the following definition:

**"Currency values"** means gold and other precious metals as well as any means with which their owner can substitute currency<sup>6</sup>.

However, the above law "On Transactions in Foreign Currency" was repealed, and in the new law which now regulates currency-related matters (the Law of 16 December

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<sup>5</sup> A strange question to many readers from countries without exchange controls. Kyrgyzstan has no exchange controls, but its law still has bits and pieces remaining from the Soviet codes on which it was originally built. The Soviet law strictly regulated not only the possession of or transacting in hard currencies, but also the business with any values which are very much like hard currency - Eg. gold bars, cheques in foreign currency etc. Thus the Soviet State was trying to regulate the population's savings and limit the people's ability to store or take abroad any value which was not controlled by the State. Those times for the Kyrgyz people are gone for good, but certain relics of the old terminology are still stuck in the corners of the country's legislation.

<sup>6</sup> One of the weirdest definitions in Kyrgyz law. Good that it's gone now.

2016 No 206 "On The National Bank of the Kyrgyz Republic, Banks and Banking") there is no definition of "currency values" to be found.

There is a definition of a "currency value" in the Administrative Liability Code:

The Administrative Liability Code (*of 4 August 1998, No 114*), Section VI

**Currency values** - foreign currency (in banknotes, treasury bills and coins), payment documents (cheques, promissory notes, letters of credit etc.) and investment values (shares, bonds etc.) denominated in foreign currency, bank payment documents purchased for foreign currency giving the right to exchange them for foreign currency; precious metals - gold, silver, platinum and platinoids (palladium, iridium, rhodium, ruthenium and osmium) in any form and condition, except for jewellery and other consumer articles and scrap of such articles; natural precious stones in raw or worked over (diamonds, rubies, emeralds, sapphires and also pearls), except for jewellery and other consumer articles made of these stones and the scrap thereof.

It is evident that on the basis of the above definition crypto-assets can not be attributed to 'currency values'.

## **Can legal and natural persons under the jurisdiction of the Kyrgyz Republic buy and sell crypto-assets?**

As was demonstrated above, crypto-assets from the point of view of the Kyrgyz law are movable things (movable property) of unrestricted circulation.

The legislation of the Kyrgyz Republic contains no specific prohibitions of transactions with crypto-assets.

As a consequence, transactions in which such assets are bought and sold are not restricted by the Kyrgyz legislation.

## **Legal regulation of crypto-asset mining in the Kyrgyz Republic**

'Mining' is the performance of computer computations which are necessary for the functioning of a certain distributed register (ledger) based on the blockchain technology. In return for exploiting his computer by such 'public-benefit' computations (they require much computational capacity which translates into heavy use of electricity), the computer's operator receives a certain number of units of the crypto-asset whose network was supported by such computations. Such crypto-assets have a market value, very often - in ordinary currencies.

From the legal standpoint, 'mining' is the performance of certain actions, the result of which brings the acquisition of a certain value. Its principal difference from the classic service-for-pay scenario is that there is no customer and no person obliged to pay for the service. One may consider picking up berries and mushrooms or looking for a hidden treasure as a half-serious analogy.

It is obvious that making mathematical computations on one's computer for the purpose of receiving certain values from the internet community does not violate the laws of Kyrgyzstan in any way.

## Taxpayer registration for 'mining'

From the position of the Kyrgyz tax law, the engagement in crypto-asset mining may either fall under the definition of "entrepreneurial activity" or stay outside of this definition. In accordance with Article 21 of the Tax Code of the Kyrgyz Republic, the activity is "entrepreneurial" if it is undertaken on a "systematic basis". The criterion of being systematic is a very strict one. If sales happen more than two times, it makes the activity "systematic".

The Tax Code of the Kyrgyz Republic.

### **Article 21. Economic activity**

1. Economic activity may either be entrepreneurial activity or other activity.
2. For the purposes of this Code economic activity of a subject shall be deemed entrepreneurial if the subject is engaged in the activity on a systematic basis.

### **Article 4. Terms and definitions used in this Code**

24) "**Activity on a systematic basis**" - activity involving realization (sale) of identical and/or similar goods, if within one calendar year more than two units of the goods were sold, as well as performance of work or rendering a service for a remuneration.

An important consequence of activity being considered entrepreneurial is the obligation of the tax subject to get registered with the tax authority. Private individuals must register as 'individual entrepreneurs'.

Having to obtain a tax registration is not necessarily a bad thing. Those who plan to professionally engage in the mining of crypto-assets can benefit from the tax registration as 'entrepreneurs' or engage in this activity through a legal entity to exclude any dispute with the tax authority about tax registration and, secondly, to deduct the expenses of the mining (first of all, electricity costs and equipment depreciation) from the gross sales when calculating the profit (or income) tax liability.

## **Crypto-assets and accounting**

It is no surprise that to this date no specific regulations on how to book crypto-assets in the accounts of a company have been published.

It appears that in the Kyrgyz accounting system (which generally follows IFRS) one may use a group of accounts within section 1300 "Short-term investments" (1390 "Other short-term investments") and section 2000 "Fixed assets" (2900 "Intangible assets", or 2800 "Long-term investments") to book crypto-assets.

If the company plans to do business with crypto-assets, it is advisable to fix the principles of their accounting in its Accounting Policy (a document setting the accounting rules applied by the company where the law allows discretion).

## **Taxation of crypto-asset mining**

Crypto-assets acquired as the result of 'mining' must be accounted for as assets that the person created itself, not as those received in a transaction - the reason being that the taxpayer used own efforts and resources to obtain them (mathematical computations) and there was no identifiable other party to reward such efforts.

Consequently, a taxable event in relation to this will be not the obtaining of a crypto-asset by the taxpayer, but only its subsequent sale or other barter for value.

The subsequent realization of the crypto-asset may be either in the form of sale for ordinary money (national or foreign currency), or by way of its barter for a different asset - the one existing on the blockchain or a traditional one.

If the crypto-asset is sold for money, the computation of the taxable profit does not present any difficulties: the taxable base will be the difference between the value received for the crypto-asset and the documented costs of its production. (Obviously, we are simplifying the explanation a bit by assuming that the taxpayer has no other activity but the mining of crypto).

If the crypto-asset is bartered for another asset, for the purposes of taxation the taxpayer will have to account for the crypto-asset as sold, and the received asset as bought. For the computation of tax the taxpayer will have to substantiate the market value of the transaction in the national or a foreign (fiat) currency, which can be done by keeping broker receipts (if the transaction is done through a broker), or printouts of quotes from the exchanges where such assets are tradable for fiat money.

## **Taxation of income received in the form of crypto-assets**

A vital issue for many freelancers and sellers of goods and services for cryptocurrencies is how to pay their Income Tax on crypto-assets received as payment.

In accordance with Article 160 of the Kyrgyz Republic Tax Code, the definition of "income" includes "the increase in assets, the receipt of tangible assets having a

monetary value and/or the receipt of tangible benefits, and also the decrease in liabilities".

While it is debatable whether a blockchain-recorded crypto-asset is a 'tangible' or an 'intangible' value, we think that the crypto-assets received as payment for a good or a service will fall under the definition of the taxpayer's "income" (if only as something which causes the "increase in assets" belonging to the taxpayer).

This position is reinforced by Article 162 of the Tax Code which says that the object of taxation by the Income Tax is any economic activity as the result of which income was received and also "the receipt of any other income".

Article 165 specifies that not only monetary means make up income, but also income received in kind: "The aggregate annual income of the tax period includes any types of income, received by the taxpayer within the tax period, in monetary form as well as in kind, in the form of work or services..."

In accordance with Article 168, the income is deemed to arise on the date when the consideration asset is received: "For the purposes of this Chapter the date when the income arises is (...) when receiving income in the form of goods - the date when title to the goods is transferred".

When the individual taxpayer receives crypto-assets as payment for his/her services or property, he/she must document the fact of receiving such payment (by printouts from the internet, if no other proof is available), and include such income into the aggregate taxable income for the relevant tax period as income received in kind. The money value of the crypto-asset received must be then recorded as per its market value on the date when the crypto-asset is received by the taxpayer.

It is likely that in the future the Kyrgyz tax authorities will issue explanatory rulings on the taxation of crypto-asset income in addition to the existing norms. However, as on today, failing any specific rulings, such income's taxation should follow the above described general rules.

## **Tax accounting of private crypto-asset investments**

In accordance with the general rule given in Article 21 of the Tax Code, a common investment of own savings (into bank deposits, securities etc.) does not qualify as entrepreneurial activity:

The Kyrgyz Republic Tax Code

### **Article 21. Economic Activity**

1. Economic activity may be entrepreneurial or a different type of activity.
2. For the purposes of this Code economic activity of the tax subject shall be deemed entrepreneurial if it is carried out systematically.
3. The following kinds of activity shall be deemed under this Code to be non-entrepreneurial:
  - 1) activity in accordance with labour law of the Kyrgyz Republic;
  - 2) investment of money into banks;
  - 3) acquisition, transfer or sale of securities, shares of a natural or legal person in the share capital;
  - 4) receipt of any payments pertaining to the share of the natural or legal person in the share capital;
  - 5) collection of penalties, fines or compensation of moral damages;
  - 6) collection of insurance compensation under an insurance contract;
  - 7) other activity which is not entrepreneurial activity.

### **Article 4. Terms and definitions used in this Code**

24) "**Activity on a systematic basis**" - activity involving realization (sale) of identical and/or similar goods, if within one calendar year more than two units of the goods were sold, as well as performance of work or rendering services for a remuneration.

However, since crypto-assets, as was demonstrated above, are clearly not securities under Kyrgyz law, non-attribution of crypto-asset investments to entrepreneurial activity may happen only if the tax authority agrees to apply the above Article *by analogy*. This is possible, but we do not think that one should rely on such a possibility.

We therefore recommend to imply that the execution of more than two transactions with crypto-assets by the individual taxpayer in the course of one calendar year will constitute 'entrepreneurial activity' and as a consequence will require the individual to register as 'individual entrepreneur'.

This is hardly good news for private investors engaged in part-time 'gambling' on online crypto-exchanges with small amounts, but the formal position of the law, absent any court practice or explanatory rulings to the contrary, is exactly as we described.

## **Raising funds through an ICO**

In accordance with the Kyrgyz law, crypto-assets are clearly not considered securities, because the Kyrgyz law (unlike the US law, for example) treats as securities only the instruments which are named as securities by law or in accordance with the procedure prescribed by law:

The Civil Code of the Kyrgyz Republic  
Article 37. A security

1. A security is a document or any other method of fixing rights provided by law which certifies property rights and conforms to the prescribed form and contains the prescribed requisites.

When a security is transferred, all the rights certified by the security get transferred.

2. Types of rights which are certified by securities, mandatory requisites of securities, requirements as to the form of securities and other necessary requirements are determined by the law of the Kyrgyz Republic or in the manner provided by the law.

The absence of mandatory requisites of a security or non-conformity of a security to the form provided for it makes such security void.

#### Article 38. Kinds of securities

Securities are: bonds, promissory notes, cheques, bank certificates, bills of lading, shares and other documents which by law or by a procedure established by law are attributed to securities.

Consequently, crypto-assets do not fall under the restrictions which are prescribed for issues of securities (such as, for example, the requirement for regulatory approval of any public placement of securities etc.)

However, such state of legislation does not mean that in Kyrgyzstan it is possible to raise funds from the general public in return for issuing crypto-assets without any regulation.

After the epidemic of Ponzi schemes in the middle of 1990s which caused so much damage to the savings of Kyrgyzstan's citizens, the Government limited the possibility to raise funds from the public by any unregulated person.

In accordance with the Decree of the President of the Kyrgyz Republic of 12 November 1994 No UP-299 "On Urgent Measures to Resolve the Issues Related to Fundraising from the General Public":

1. The raising or the public offer of raising from natural persons whose number is not limited and the personal list of whom can not be predetermined, of money<sup>7</sup> for a certain term or for any consideration, can be effected only by legal entities and only if they possess a relevant license, prescribed by the law for banks, investment institutions, insurance or other organizations.
2. The mass media may place advertisements of open sale of securities or of the raising of money by legal entities (for a term or for consideration) only when the document is produced proving that the securities issue was registered by the State or that the relevant license is available.

This norm means that collection of money from the undetermined number of private individuals for consideration (which happens in the ICO scenario) is only possible for legal entities which have an investment institution license (i.e. such of a 'professional participant of the securities market) - even if the instrument being placed is not recognized by law as a security.

The authors of this report think that the best way to avoid legal uncertainty when conducting an ICO from within the Kyrgyz jurisdiction and at the same time to gain a competitive edge on the financial market (by demonstrating definite legality of the ICO) is to conduct the ICO within the framework prescribed by the Kyrgyz law "On the securities market" for the public placement of securities issued by a Kyrgyz or a foreign company.

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<sup>7</sup> Note that the restriction covers only the raising of money. Potentially, the legislation should be expanded to protect the retail investors from unregulated collection of non-monetary assets (such as crypto-assets) as well.

This necessitates the observance by the issuer of the Kyrgyz law's requirements for filing of certain documents with the regulator (such as the issue prospectus), engagement of a licensed underwriter and undergoing the listing procedure on the local stock exchange.

The Kyrgyz Stock Exchange (KSE) has a special section for equity and debt of startup companies.

Public placement rules in the Kyrgyz Republic generally follow the average international standards and are fairly easy for compliance by bona fide issuers.

As will be demonstrated below, an IPO under Kyrgyz law can have all the required features of an ICO.

The licensed underwriter which must be engaged in the course of any public placement (a local brokerage company) is free to collect not only money, but also crypto-assets in the course of subscription - provided that such crypto-assets will be immediately sold, and the issuer's account will be credited with fiat money (this is a direct requirement of the law).

If the investor prefers to own blockchain-based tokens to represent his/her rights in the shares (instead of the actual shares), it is not hard to establish this mechanism through a licensed investment manager. A more detailed description of the legal and technological scheme which has been created to achieve this is beyond the scope of this report.

## Limitations on advertising ICOs and crypto-assets

Founders of projects aiming to raise funds publicly must take into consideration the existence of restrictions in the Kyrgyz advertising laws for financial services related advertising.

The Kyrgyz Republic Law of 24 December 1998 No 155 "On Advertising"

Article 17. Special regulations for the advertising of financial and investment services and securities

It shall be forbidden, when producing, placing and distributing the advertising for financial (including banking), insurance, investment and other services related to the use of funds of natural and legal persons, and also of securities, to do the following:

- to provide in the advertisement any quantitative information not having a direct relation to the services or securities being advertised;
- to guarantee the size of dividends on common registered shares;
- to advertise securities before their issue prospectus is registered;
- to provide any sort of guarantees, promises or assumptions of the future effectiveness (profitability) of business, and in particular by announcing the growth of the market value of the securities;
- to withhold information on any provision of the agreement if the advertisement informs of the terms of the agreement.

For blockchain-related commerce the most important provision to note is the prohibition to provide any sort of "assumptions of future efficiency (profitability) of the business". Regrettably, many ICOs being launched now involve the advertisement of unfounded assumptions as to the future growth of the market value of the tokens distributed in the course of the ICO.

Maliciously (intentionally) misleading advertisement is punishable as a crime under the Criminal Code of the Kyrgyz Republic:

The Criminal Code of the Kyrgyz Republic

Article 192. Intentionally false advertising

(1) The use by advertisers of knowingly false information regarding the goods, works, services or their producers or sellers, or the advertising of products which are subject to mandatory licensing but which have no compliance certificate or a license, if done with a view to a gain, -

shall be punished by a fine up to 50 'settlement units' or by public works for up to 100 hours.

(2) Same actions done:

1) with the use of mass media;

2) which have caused serious damage, -

shall be punished by a triple restitution [ayip], or a fine from 50 to 100 settlement units or by public works for up to 200 hours.

Note. Serious damage in this Article shall mean a damage of 20 settlement units - for natural persons, and 50 settlement units - for legal persons. The monetary value of a 'settlement unit' shall be as set by the Kyrgyz legislation on the date of crime.

## **Protection of investors from fraudulent ICOs**

If the fundraising is made without the intention to provide the promised value in return for the investors' money/assets, this can constitute Fraud under the Criminal law of Kyrgyzstan:

The Criminal Code of the Kyrgyz Republic

Article 166. Fraud

(1) Fraud, that is, acquisition of someone else's property or a right to property by deceit or by abuse of trust, -

is punishable by public works from 180 to 240 hours or by triple restitution [ayip] or by correctional works for the term up to two years or by imprisonment for up to one year.

(2) Same act committed:

1) by a group of persons;

2) by a group of persons by prior collusion;

3) on a significant scale, -

is punishable by a fine from 50 to 300 settlement units or by triple restitution [ayip], or by correctional works for up to 3 years, or by imprisonment from 1 to 3 years.

(3) Same act committed on a large scale, -

is punishable by imprisonment from 3 to 5 years.

(4) Same act committed:

1) by an organized criminal group;

2) on an especially large scale;

3) through abuse of office;

4) by a person who was convicted two or more times for theft or extortion, -

is punishable by imprisonment from 5 to 10 years with confiscation of property.

Taking into account the cross-border nature of crimes committed over the internet, it is worth examining what are the limits of the Kyrgyz Republic's criminal jurisdiction over the cases where a crime was committed on the territory of another State (Eg. if the beneficiaries or promoters of a fraudulent ICO were acting from abroad, and Kyrgyz residents are among the victims).

In accordance with the Criminal Code of the Kyrgyz Republic:

Chapter 2. Limits of application of criminal law

Article 5. Application of criminal law in relation to persons who committed a crime on the territory of the Kyrgyz Republic

(1) All persons who committed a crime on the territory of the Kyrgyz Republic are subject to criminal liability under this Code.

(2) If the crime is committed on the territory of another State, criminal liability under this Code arises if the crime is finished or curbed on the territory of the Kyrgyz Republic.

In accordance with legal doctrine, the crime of Fraud is considered to be 'finished' with the loss of money or property by the victim. It is considered 'completed' as of the moment when the perpetrator acquires a legally fixed possibility to own or dispose of another's property as his own.

Therefore persons whose fraud in the course of an ICO caused damage to the residents of the Kyrgyz Republic can be held criminally liable in the Kyrgyz Republic even though their criminal acts were committed outside of the country.

This position is supported by the legal doctrine. Commentary to the Criminal Code of the Kyrgyz Republic (recommended for publication by the Academic Council of the Chui University, authors: T.A. Asanaliev, A.Zh. Karimbekov, K.M. Osmonaliev) reads:

A crime is considered committed on the territory of the Kyrgyz Republic both when criminal acts were commenced and completed in the country (which includes the occurrence of the legally defined result of the crime), but also when the criminal acts were committed outside of the Kyrgyz Republic, but the criminal result occurred within its territory.

## **Inheritance of crypto-assets**

Since under the law of the Kyrgyz Republic crypto-assets conform to all the characteristics of movable property (movable things; *res mobiles*), their inheritance under Kyrgyz law should follow the rules for the inheritance of movable things, and may either be effected by will or by direct application of law.

A peculiarity of crypto-assets is that it is impossible to pass them to another person by inheritance without ensuring that this person possesses the key (password) to manage the crypto-wallet where the crypto-assets are stored. In practice this means that the testator must not only appoint the heir to receive the crypto-assets (by will or by relying on the inheritance distribution rules of the applicable law), but also work out a mechanism to have all the required requisites and passwords delivered to that person at the right time.

If the crypto-asset is held by a third party on a contractual or fiduciary (trust) basis, for example by a depository, a custodian, an exchange clearinghouse, a broker or an investment manager), inheritance must be structured as the passing of contractual (or fiduciary) rights / interest of the beneficiary to the heir. It is advisable that the fiduciary holding the crypto-asset in favour of its client is made aware of the inheritance arrangement when the arrangement is made, and that the contract between the client and the fiduciary does not hinder the transfer of assets through inheritance.

## **Pledges of crypto-assets**

Under Kyrgyz law, crypto-assets satisfy all the characteristics of movable property (movable things; *res mobiles*), therefore their pledge under Kyrgyz law should follow the rules for pledges of movable property.

From the practical point of view this would require that the pledged property (which translates into the actual possibility to dispose of the crypto-asset) should be transferred to the creditor, and the rights of the pledgor against the creditor potentially abusing his position of owner-in-fact will have to be safeguarded contractually.

A more complex arrangement can be worked out with the involvement of a third trusted party, such as a custodian or licensed asset manager which can hold the asset on the terms agreed by the creditor and the pledgor (a tripartite agreement will then be made).

## **Trading crypto-assets on exchanges in the Kyrgyz Republic**

Currently a serious problem for the global crypto-commerce is the lack of duly regulated exchanges for crypto-assets. The absolute majority of so-called 'virtual currency exchanges' or 'crypto-exchanges' are either not regulated in any way, or operate relying on licenses which do not entirely cover the actual business of an exchange.

For example, such enterprises may operate under the European Union license to issue electronic money (the e-money license), a payment institution license or similar regulatory surrogates. At the same time, the only adequate regulation of a financial institution doing business as an exchange is, naturally, such of an exchange.

Operating under a substitute license or with no license at all carries a risk of not only regulatory intervention in the future, but also of private litigation against the platform, should a participant of the exchange trading suffer losses due to its inadequate regulation.

Luckily, the peculiarity of Kyrgyz law allows the exchanges legally operating in the country to organize trade in crypto-assets without a need to specifically adapt the local legislation to this activity.

This means that the exchanges of the Kyrgyz Republic can offer global investors and investment intermediaries a regulated platform to trade crypto-assets which is much more stable in the legal perspective than the majority of internet exchanges existing today.

\* \* \*

In accordance with the laws of the Kyrgyz Republic, two types of regulated exchanges can operate under its jurisdiction - stock and commodity.

### ***Stock exchange***

The business of a stock exchange is regulated by the Kyrgyz Republic Law "On the Securities Market"; in accordance with this law, the exchange's regulator is the "authorised State body for the regulation of the securities market", which is now the Financial Market Regulation and Supervision Service of the Government of the Kyrgyz Republic (GosFinNadzor, for short).

Besides being supervised by the industry regulator, the stock exchange is a "reporting entity" under the legislation against money laundering (in accordance with the Kyrgyz Republic Law of 31 July 2006 No 135 "On Countering the Laundering of Criminal Proceeds and the Financing of Terrorism and Extremism". It must file AML-related reports (mandatory reports on large transactions and suspicious activity reports) with

the country's financial intelligence unit which is The Financial Intelligence Service of the Kyrgyz Republic.

### ***Commodity exchange***

The business of a commodity exchange is regulated by the Kyrgyz Republic Law of 29 June 1992 N 915-XII "On The Commodity Exchange and Exchange Trading in the Kyrgyz Republic". The law does not provide for the licensing of a commodity exchange but sets out a number of requirements which such exchanges must correspond to - for example, limiting one's share in the capital of the exchange (10%), the prohibition of any other activity except such of an exchange, the requirement to adopt exchange rules and regulations etc. The law further provides for the obligation of the commodity exchange to notify the securities market regulator of the terms of standard derivative contracts tradable at the exchange.

Similar to the stock exchange, the commodity exchange is a "reporting entity" under the anti-money laundering law and must file reports with the Financial Intelligence Service of the Kyrgyz Republic.

### ***Differentiation in tradable assets***

In accordance with the Kyrgyz Republic Law "On the Securities Market", a stock exchange can organize trading in securities including derivative securities. Under paragraph 13 of Article 50 of this law, a stock exchange can also combine its securities trading business with commodity trading (subject to certain formalities with the regulator).

In accordance with the Kyrgyz Republic law "On Commodity Exchange and Exchange Trading in the Kyrgyz Republic" (Article 8), "the following transactions can be executed on commodity exchanges:

- purchase and sale of actual goods, including transactions when the object of sale is deliverable immediately and those when title documents to the goods are transferred;
- forward transactions - purchase and sale of actual goods with deferred delivery;
- futures transactions - purchase and sale of standard contracts;
- option transactions - purchase and sale of rights to buy or sell goods or delivery contracts at a certain price in the future;
- as well as other transactions involving the sale and purchase of goods, contracts or rights, as provided in the regulations of the exchange".

In accordance with the Regulations on the Types, Terms of Issue and Circulation of Derivative Securities and the Requirements as to their Base Assets in the Kyrgyz Republic", promulgated by the Kyrgyz Republic Government Resolution of 29 March 2017 No 185, derivative financial instruments **issued as securities**, can be tradable on the **stock exchange**, and derivative contracts **not categorized as securities** - also on the **commodity exchange**.

Standard derivative commodity contracts not falling under the definition of securities must be registered (by notification) with the securities market regulator (GosFinNadzor):

Regulations on the Types, Terms of Issue and Circulation of Derivative Securities and the Requirements as to their Base Assets in the Kyrgyz Republic:

34. The terms of option, forward and futures contracts which are not securities, tradable on the stock or the commodities exchange are determined by the exchange and the exchange shall allocate a unique number to each such contract. Within 15 calendar days of entering a new contract into the trading system of the exchange, the exchange shall notify the authorised State body on regulation of the securities market in writing of the terms of such contract by filing them with such body.

It needs to be noted that general civil law of the Kyrgyz Republic does not contain a definition of a "financial instrument" (unlike Russian law, for example), and therefore the regulatory legislation is forced, with much doctrinal inconvenience, to use the term "security" even where it deals with a contract which is not a security in accordance with the law.

For example, paragraph 5 of the Regulations on the Types, Terms of Issue and Circulation of Derivative Securities and the Requirements as to their Base Assets in the Kyrgyz Republic, forcedly contains a weird-sounding norm distinguishing "derivative securities issued as securities" and "derivative securities issued as contracts which are not securities":

5. Derivative securities may be issued as securities if they conform to the following conditions:

- 1) the issuer is a person obligated under the contract;
- 2) the issue is in the form of documents which certify rights, and such rights are transferred with the transfer of such documents;
- 3) all the contracts in one issue contain the same terms;
- 4) the issue was subject to State registration in accordance with the law on the securities market.

We expect that as the Kyrgyz civil law develops it will contain a more general notion of a "financial instrument" at the level of the Civil Code, and this will allow to avoid calling ordinary commodities contracts "securities" in regulatory legislation.

Nevertheless, the Kyrgyz Republic's legislation now in a very definite manner distinguishes between securities and contracts which are not securities. A security (in the context of regulating derivative instruments) is characterized first of all by having an 'issuer', and by existing within the framework of an issue of documents which embody a certain right, each such document being of identical terms within the issue.

Contracts following a common specification (standard terms) which are not being "issued" by any particular person, but rather made available on the exchange for any two parties to execute, are not securities.

A **stock exchange** can thus organize the trading in securities and derivative instruments, both classified as securities or not. A stock exchange can also be a platform for trading commodities, but only if it is registered to combine both of these activities.

A **commodities exchange** can not operate the trading in securities (neither ordinary, nor derivative), but can be a market for commodities (goods) and any goods-related derivative contracts which are legally not categorized as securities.

## **Crypto-assets traded on the exchange**

As was demonstrated above, crypto-assets under Kyrgyz law are a category of "movable things" (*res mobiles*) and are not securities because the law lacks a provision attributing them or any of their kind to securities.

However diverse in forms and functions, crypto-assets, being a kind of virtual (electronic) property existing on the internet, are in the context of commerce, and in particular commerce transacted on an exchange, considered to be "goods".

In accordance with paragraph 1 Article 417 of the Kyrgyz Republic Civil Code, "Goods<sup>8</sup> in the contract of sale can be any things, subject to Article 23 of this Code".

Article 23 ("Objects of civil rights in civil circulation") reads as follows:

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<sup>8</sup> A terminology note. In Russian "goods" and "commodities" are the same word - *tovar*.

1. Objects of civil rights can be freely alienated or transferred from one person to another as a matter of universal succession (inheritance, legal entity reorganization) or by any other means, unless the legislation removes them from the civil circulation or limits their civil circulation.

2. Types of objects of civil rights which may not be in civil circulation (objects removed from civil circulation), must be directly named in law.

Types of objects which may be owned only by specifically determined participants of the civil turnover, or the circulation of which is allowed only by special permission (object with limited circulation), are determined by a procedure established by law.

Crypto-assets are not objects removed from circulation or limited in circulation because no direct provision of the law exists to that effect.

The Kyrgyz Republic's laws regulating specific aspects of economy follow the general definition of "goods" given in the Civil Code:

Law of the Kyrgyz Republic N 40 of 20 March 2002 "On Domestic Trade in the Kyrgyz Republic"

Article 2. Principal Terms Used in this Law

**goods** - any product of labour not removed from circulation which is intended for sale or barter; (...)

Law of the Kyrgyz Republic N 149 of 8 August 2011 "On Natural Monopolies in the Kyrgyz Republic"

Article 3. Main Definitions

**goods** - object of civil rights (including work and services) intended for sale, barter or any other introduction into circulation; (...)

Based on the qualification of crypto-assets as "goods", the following transactions with crypto-assets can be concluded on the **stock exchange**:

- transactions with securities issued as crypto-asset linked derivative securities;
- transactions with shares in investment funds which hold crypto-assets;
- transactions with any foreign securities linked to crypto-assets, provided that such securities were approved by the Kyrgyz financial market regulator for distribution in the Kyrgyz Republic.

On the **commodities exchange** the following transactions can be concluded:

- transactions in relation to actual crypto-assets;
- derivative contracts in relation to crypto-assets, provided such contracts are not "securities".

## **Crypto-assets and AML controls**

The Law of the Kyrgyz Republic of 31 July 2006 N 135 "On Countering the Legalization (Laundering) of Criminal Proceeds and Financing of Terrorism and Extremism" (as amended) incorporates the most modern AML regulation based on the FATF standards.

The definitions in the law (Article 2) are formulated wide enough to unquestionably include crypto-assets:

**criminal proceeds** - any economic benefit or property received or acquired, directly or indirectly, as a result of a crime;

**property** -things, objects and assets being things or rights and having a material value (movable and immovable property located in the Kyrgyz Republic or elsewhere, securities, precious stones and metals, antiquities and other property in accordance with

the legislation in effect), as well as legal documents and instruments confirming title or interest in property; (...)

Banks, professional participants of the securities market (broker-dealers and investment managers) as well as commodities and stock exchanges are all subject to the AML Law's requirements to identify their customers and monitor their transactions from the AML standpoint. They are all 'reporting entities' to the country's financial intelligence unit.

## **Regulation development recommendations**

Kyrgyzstan's civil law extends its regulation over any phenomenon having material value (whether tangible or existing only in electronic form). We consider this to be a big advantage of the Kyrgyz law.

We do not think that fixing a specific definition for crypto-assets in law would make sense now, because the technology behind this phenomenon is developing very fast and is likely to change the attributes and the functionality of such assets in the future. Any definition given now will most likely be technologically obsolete even before such law passes all the preparatory stages and goes into full effect.

Protection of retail investors from potentially fraudulent offers of virtual assets may need to be addressed by the legislation more thoroughly. Currently the only bar against unregistered offers of securities-like assets in the Kyrgyz Republic is the Presidential Decree of 1994 adopted to deal with the proliferation of Ponzi schemes over 20 years ago.

Without reducing the competitiveness of the Kyrgyz Republic as a venue for global fundraising, it might make sense considering to regulate the public placement of virtual investment instruments. It would only benefit the investing public and bona fide issuers

if the issue of securities-like tokens becomes subject to the same regulatory oversight as the issue of securities.

As far as AML regulation of the virtual assets business is concerned, the current law of the Kyrgyz Republic already extends its regulation to crypto-assets by containing wide enough definitions for its scope of application.

To discuss any legal aspects of blockchain-related business in the Kyrgyz Republic please contact the authors of this report.

International Finance Centre Development Agency

[www.kyrgyzbusiness.com](http://www.kyrgyzbusiness.com)

Valery V. Tutykhin, Director

[salam@kyrgyzbusiness.com](mailto:salam@kyrgyzbusiness.com)

cell +41 79 775 75 75

cell +41 79 870 05 27

cell +996 552 090 070

(WhatsApp / Signal / Threema)

John Tiner & Partners Eurasia

[www.jt-eurasia.com](http://www.jt-eurasia.com)

Nazgul Bakirdinova, Director

Office +996 312 96 04 40

Cell +996 556 955 994

[salam@jt-eurasia.com](mailto:salam@jt-eurasia.com)

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