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Enforcement of Japanese Law on Crypto Currency and Future Issues

**Kazuyuki Shiba, Principal Economist
Institute for International Monetary Affairs**

The amended Act on Settlement of Funds (commonly called "Crypto Currency Act") which was enacted on May 25th 2016, took effect on April 1st 2017, earlier than originally anticipated.

Unlike the "legal currency" which each country centralizes and manages and issues, the crypto currency generally indicates those (1) of which value is not guaranteed by the nation or the central bank, (2) dispersed as electronic data on the network, (3) and its management is de-centralized. There are about 700 kinds of confirmed crypto currencies in the world as of April 10th 2017 (9:00AM Tokyo), and the market capitalization of the whole is rapidly increasing to about JPY3.1 trillion (which is equal to about USD28 billion)¹.

In parallel therewith, troubles related to crypto currency transactions are also increasing. According to a report released by the National Consumer Affairs Center of Japan (NCAC) on March 30th 2017², the number of related consultations increased year by year, from 194 cases in 2014, to 440 cases in 2015, and 634 cases in 2016. In the same report, NCAC showed some cases like (1) the consumers purchased crypto currency by trusting the word "always profitable" but money was not returned as promised, (2) the customers trusted the sales talk at the seminars that said "you can get a large amount of dividends" but they could not withdraw the money as explained. And NCAC called everyone's attention to troubles of crypto currency.

The reason for the enactment of "Crypto Currency Act" at this time is the necessity of supervising the crypto currency reflecting the tendency of protecting customers both at home and abroad and strengthening countermeasures against money laundering³. The main revisions include (1) the definition of crypto currency, (2) introduction of crypto currency exchanger's pre-registration system and supervision regulation by the Financial Stability Agency (FSA), and

¹ Refer to <http://coinmarketcap.com>. Incidentally, at the time The Eyes of IIMA "Can the "Bitcoin" gain Citizenship? (2017.2.6)" was issued, there were about 650 kinds of crypto currencies in the world, and the market capitalization of the whole was about JPY2.0 trillion (which is equal to about USD17 billion).

² Refer to http://www.kokusen.go.jp/news/data/n-20170330_1.html (Japanese language only).

³ Refer to FSA leaflet <http://www.fsa.go.jp/common/about/20170403.pdf> (Japanese language only)

(3) protection of users and users' properties (See Appendix).

Also, along with the act described above, a crypto currency exchanger was added to "Specified Business Operator" who under the "Act on Prevention of Transfer of Criminal Proceeds" which sets measures against money laundering (Article 2-2-31), is obligated to confirm the identification when one opens an account (Article 4), and to report suspicious transactions to the authorities (Article 8), etc.

In addition, the "Annual Tax Revision Plan (FY2017)"⁴ which was decided on December 22nd 2016 clearly stated that consumption tax on transferring crypto currency will be abolished after July 1st 2017.

From the viewpoint of users of the crypto currency, the enforcement of such acts and the revision of the tax system will lead to the expansion of its use with the feeling of security that the government will supervise the exchanger hereafter. Actually, it seems that many users are taking these countermeasures favorably.

However, the maintenance of other institutional aspects relating to crypto currency is actually lagging behind. Specifically, three issues can be pointed out.

The first issue is that there is no uniform accounting standard for crypto currency. For example, (1) when holding a crypto currency should the asset side be recorded as "financial product" or "inventory asset" or "crypto currency (subject is to be newly established)"?, (2) which method of accounting the value should be used at the end of the term "book value" or "market price", and if the "market price" is adopted, which exchangers' reference price should be used? In order to solve these problems, the deliberation began at the ASBJ on March 28th 2017, but it is expected to take at least six months before the summary of the outline is formulated.

The second issue is that there is no institution that accepts the customer's crypto currency as a trust property to be "separately managed". When a customer purchases a listed stock at a securities company, it will be kept at the third party institution called "Japan Securities Depository Center (JASDEC) ", and the money is separately managed as "customer sorted money" in their trust property by the trust bank. Also, when the customer purchases an investment trust at a securities company or a bank, it will be kept and managed as a trust property by the trust bank under a trust contract with an investment trust company. But, as the crypto currency is neither "money" nor "monetary claim", there are no third party institutions or trust banks that can manage it at present. Also, you cannot "deposit" it to the Legal Affairs Bureau.

The third issue is that the crypto currency is not specified as the property subject to foreclosure under the "Civil Execution Act" and "National Tax Collection Act". Therefore, if an

⁴ Refer to https://www.mof.go.jp/tax_policy/tax_reform/outline/fy2017/20161222taikou.pdf (p93-94) (Japanese language only)

individual or a company exchanges his or her property to a crypto currency when the risk of his bankruptcy increased, the creditor may not be able to collect it.

Therefore, in order to make crypto currency transaction truly reliable, it is necessary to quickly fill up the "holes" of the above-mentioned institutional aspect, rather than try to address the incidents after the social interest increased in such scandals as "Mt GOX incident" which occurred on February 2014.

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Overview of “Crypto Currency Act”

Article Number	Article Name
Overview of the Article	
① Article 2.5	Definition of "Crypto Currency" Crypto Currency is, (1) The property value that can be used to unspecified persons for the purpose of paying their expenses when purchasing, borrowing, or receiving the services of goods, and also can be purchased and sold to unspecified persons as counterparties. It can be transferred using an electronic information processing organization. (Except for domestic / foreign currency and currency denominated assets) and, (2) The property value that can be mutually exchanged with an unspecified person as the counterparty listed in the preceding issue, and can be transferred using an electronic information processing organization. ⇒ <u>Although "Crypto Currency" is not a legal currency, it is interpreted as "one of the means for settlement."</u>
② Article 63.2	Introduction of Registration System for "Crypto Currency Exchange Business" Define the crypto currency exchange business (Article 2.7) and person to register with the Prime Minister (FSA) after satisfying the capital requirements, property basis, etc. as a crypto currency exchanger.
③ Article 63.10	Measures for Protection of the User The crypto currency exchangers ought to protect the user by providing explanations to prevent mistaken recognition between handling crypto currency and the Japanese and/or foreign currency. Also, they ought to provide information to the user on the fee and information on the contents of the contract between the crypto currency exchanger and the user.
④ Article 63.11	Management of User Property (1) Crypto currency exchanger must separate and manage the user's money or crypto currency from their own money or crypto currency when exchanging to crypto currency. (2) Crypto currency exchanger shall periodically receive an audit by a certified public accountant or an audit corporation.
⑤ Article 63.13 through 16	Supervision of "Crypto Currency Exchange Industry" Crypto currency exchanger is under supervision regulation, for example, preparation of books and reports, submission of reports with audit report attached, on-site inspection, order for business improvement, etc.

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