COMMERCIAL TOKENS IN THE FRENCH ECONOMY: USE CASES AND LEGAL CHALLENGES

EXECUTIVE SUMMARY

Blockchain technologies associated with autonomous computer programs called "smart contracts", notably on the *Ethereum* blockchain, have given birth to digital tokens. Use cases for these tokens have emerged, which are either financial or commercial. The report deals with the latter.

Commercial Tokens (CTs) are mostly present in the video games sector, the luxury goods industry and in the art world. All those use cases rely on the capacity of those tokens to introduce "ownership" in the digital realm and consequently, sales and transferability between users. Tokens connect a wallet and its owner with a digital object such as a video game character, an artistic image or a representation of a luxury handbag to be displayed in the metaverse. With the exception of artistic tokens in the form of NFTs, , there is a good or a service associated with the sale of the token provided by the issuer in each of those use cases.

As of today, the **impact of these tokens on the French economy remains limited**. However, the fast-moving and innovative nature of blockchains may lead to the emergence of new applications in the near future. **The French ecosystem around crypto assets and commercial tokens is dynamic but still in its infancy. It is no. 1 in the European Union** on par with Germany. It lags behind the United States, the United Kingdom and Switzerland. It relies on some of the French economy's strengths (skills in fundamental computing, global players in the luxury and video game industry that have embraced the technology) and a clear regulatory framework with the PACTE law voted in 2019. However its development is stymied by difficulties in accessing the banking system for start-ups due to anti-money laundering policies and by the lack of French investment funds able to invest in tokens due to regulation.

With **regard to legal and regulatory challenges, a number of issues need to be addressed in order to provide greater legal certainty and mitigate potential risks**.

(i) The information and protection of consumers buying commercial tokens is not sufficient. To remedy this situation, the nature of the rights associated with the acquisition of tokens, such as the conditions of access to the goods or service linked to the token, **must be clearly established and made public when the tokens are issued.** The contractual obligations of the issuer should be embedded in the tokens as well as the consequences of a secondary sale on the rights of the new buyer. In case the goods or services associated with the token change over time or with usage, for instance a limited number of accesses to a part of a metaverse, mechanisms must be implemented to track the "consumption" of the goods or services prior to a secondary sale.

(ii) Tokens in the form of NFTs associated with works of art require specific attention. They do not provide access to an existing good or a service and they are not, *per se,* works of art or titles of ownership, according to French law. The work of art is independent of the token and stored in an open data base where it can be downloaded by any user. Furthermore, the token offers no guarantee that its issuer is the rightful owner of the work of art or that the work of art linked to the token has not been tampered with. At best, these tokens are a representation of the economic rights associated with the work of art provided that they incorporate some form of a license agreement. The development and standardization of such agreements should be encouraged.

(iii) Adjustments of the European Market in Crypto Assets (MiCA) regulation should be contemplated in future versions:

- NFTs, currently carved out by a recital, must be included in the scope of the regulation and regulated like utility tokens.
- NFTs and utility tokens should be included within the scope of market abuse provisions and, in order to prevent market manipulation, issuers of those tokens should be prohibited from dealing in the secondary markets for their tokens.
- Peer-to-peer exchange platforms (such as *OpenSea*) should be included within the scope of MiCA, with a specific regulatory regime aimed at mitigating money laundering and market abuse risks.
- The current regime that does not require a white paper for utility tokens except in designated circumstances would continue. However, the obligation of token issuers to enshrine their contractual obligations in the tokens suggested above should be considered in future regulation.

(iv) A further tightening of anti-money laundering regulations should be envisaged. A new European regulation aiming to ensure that crypto transfers can always be traced and that suspicious transactions can always be blocked, as it is the case with any other financial operation, will enter into force in the near future.

This rule requires that information on the source of the asset and its beneficiary travels with the transaction and is stored on both sides of the transfer. The rules would also cover transactions above €1,000 from so-called unhosted wallets (a crypto-asset wallet address of a private user) when they interact with hosted wallets managed by crypto-assets service providers (CASPs).

CASPs have an obligation to collect but not to verify the accuracy of the information provided by the owner of an unhosted wallet above the €1,000 threshold. This loophole should be closed and CASPs should have an obligation to verify who owns the unhosted wallet. In order to facilitate the implementation of this obligation, the identification of unhosted wallets should be encouraged. Identity service providers could create identity tokens irreversibly attached to wallets that would disclose the identity of the wallet's owner to selected parties when needed. Further tightening could be envisaged by prohibiting any transaction above €1,000 through a CASP when an unidentified and unhosted wallet appears in the chain of transactions.

In terms of scope this regulation does not cover transactions on NFTs and peer-to-peer platforms have no obligations. This should be corrected in the future if and when they are brought into the scope of MiCA.

(v) From a French income tax perspective, tokens with a commercial purpose should not be considered as digital assets as defined by the PACTE law. Insofar as these tokens represent an underlying right, they should be qualified as digital goods or services and taxed.

LIST OF PROPOSALS

Rights and obligations associated with tokens

Proposal no. 1: all Commercial Tokens issued and/or traded in the European Union must include a contractual document defining the rights and obligations embedded in the token benefiting the token holder.

Proposal no. 2: Confirm the compatibility of the provisions of the French Intellectual Property Code relating to copyright transfers (article L. 132-7) with a license to transfer rights to the token holder and amend these provisions if needed. Provide a model license agreement that could be used by economic players.

Taxation of tokens

Proposal no. 3: Apply to capital gains realized on commercial tokens the tax regime applicable to their underlying assets, i.e. that applicable to movable property, and not the regime applicable to digital assets under article 150 VH *bis* of the General Tax Code.

Scope of MiCA regulations

Proposal no. 4: When the MiCA regulation is revised, extend its scope to non-fungible tokens. Apply the same regime to non-fungible tokens as to *utility tokens*. Clarify that the category of *utility tokens* includes tokens which themselves constitute an existing or operational good or service, like artistic NFTs.

Combating market abuse

Proposal no. 5: Make the prohibitions in Title VI of the MiCA Regulation applicable to all cryptoassets, regardless of whether or not they are admitted to trading on a centralized platform.

Proposal no. 6: Make platforms that put buyers and sellers in contact with each other, other than CASPs, subject to a regulatory regime lighter than the one applicable to CASPs that includes obligations of loyalty, transparency, diligence and vigilance with regard to transactions involving risks in terms of AML/CFT and market manipulation.

Proposal no. 7: Prohibit issuers of tokens for commercial purposes and any persons acting in concert from redeeming in *fiat* currency or mass-market cryptocurrencies (bitcoin, ether, *etc.*) the tokens that they have issued.

Proposal no. 8: Examine the advisability of requiring directors of entities issuing tokens to declare the transactions they carry out on their own behalf involving these tokens.

Combating money laundering and the financing of terrorism

Proposal no. 9.A : Extend the transfer of funds regulation (TFR) to non-fungible cryptoassets and to transfers made via the *Lightning Network*. Make it compulsory to verify the identity of the holder of a self-hosted wallet for any payment over €1,000 made to or from a CASP or of a professional nature. This identity verification could be delegated to a trusted service provider guaranteeing that the wallet holder is identified.

Proposal no. 9.B: If proposal 9.A is deemed insufficient in terms of AML/CFT, consider prohibiting CASPs from carrying out or accepting cryptoasset transactions from or to a self-hosted wallet for an amount in excess of €1,000. For the application of this rule, create a status for *non-custodial hosted wallets* assimilated to that of CASPs.

French Ecosystem

Proposal no. 10: Renew the dialogue between regulators and the banking sector to ensure that Web 3.0 companies have access to a bank account.

Proposal no. 11: Encourage the emergence of a French custody solution to facilitate token investment and gain sovereignty. Such a mission could be entrusted to the *Caisse des dépôts et consignations*, which has developed expertise in this field.