

Putting Malta government on the blockchain¹

Hereunder is the original text I have written that has been modified to fit the topic in discussion. Credit is also given to the people who have contributed a lot to the Maltese community notably Dr. Jonathan Galea who had the courage and hindsight to write the first “thesis” on blockchain when no one dared to. To the contrary, I could spot quite a few term paper topics dedicated to the smart contracts and cryptocurrency and that is an encouraging sign of blockchain/crypto lawyers/notaries to come.

Modified text to follow – note (ROC = Registry of Companies):

“We aim to be the global trailblazers in the regulation of blockchain-based businesses and the jurisdiction of quality and choice for world class fintech companies,” tweeted the Prime Minister Joseph Muscat in March 2018 as he welcomed Binance, one of the largest crypto-exchanges in the world to Malta. Malta is being heralded as the ‘Blockchain Island’ and at the time of writing, the Government is fast tracking a consultation document involving the promulgation into law of three proposed pieces of legislation namely, the MDIA Bill², the TAS Bill³ and the VC Bill⁴. Locally, the first ideas about the Distributed Ledger Technology that were actually penned was through Dr Galea’s in his thesis submitted in May 2015 “The Effect of Bitcoin on Money Laundering Law”.

Whilst at the time of his writing the industry was pretty much still in it’s infancy, Galea managed to come up with a lot of forward thinking ideas which today have now occurred or are actually happening. Whilst Galea suggested changes in the AML Framework⁵ which is something which would be difficult to envisage to happen (since our laws have to always be compliant with Moneyval), in the DLT Regulation Consultation Document the MFSA received overall support for the introduction of a ‘Financial Instrument Test’ proposed in the Discussion Paper that will provide the industry with regulatory certainty on whether, based on its specific features, an initial coin offering (ICO) or a virtual currency falls within the scope of the existing legislative framework, reflecting EU law on the subject, or if not, whether this will be required to comply with the new regulatory framework being proposed by the MFSA. In other words, it means that the government will somehow manage to regulate coins and tokens thus kick-starting the digital revolution. The three pieces of legislation mentioned earlier are being rushed to bill stage so as to kick start a new digital revolution by being one of the first in Europe to legislate virtual currencies and activities

¹ Imran Bashir, Mastering Blockchain – Second Edition — Paperback – (Packt Publishing, April 2018), Abstract: “Blockchain is a distributed database that enables permanent, transparent, and secure storage of data. The blockchain technology is the backbone of cryptocurrency – in fact, it’s the shared public ledger upon which the entire Bitcoin network relies – and it’s gaining popularity with people who work in finance, government, and the arts.”

² A Bill to provide for the establishment of an Authority to be known as the Malta Digital Innovation Authority.

³ A Bill to provide the framework for the registration of Auditors and Administrators of Distributed Ledger Technology Platforms and the certification of such platforms.

⁴ A Bill that will provide the framework for the regulation of Initial Coin Offerings and intermediation of virtual currencies. The intermediaries subject to the Virtual Currency Bill include brokers, exchanges, wallet providers, asset managers, investment advisors and market makers dealing in virtual currencies.

⁵ The Effect of Bitcoin on Money Laundering Law, Dr J. Galea, May 2015, 4.3 - CHANGES IN THE AML FRAMEWORK p 87.

related to them. Why is this point important to be mentioned in this paper? To begin with, since the topic is quite novel there should be a simple explanation of how the blockchain works, and how the government can create its own token and take advantage of the technology to raise funds and give a sense of security when giving a government service to its citizens. Quoting the consultation document “Malta, A Leader in DLT Regulation” page 6 which defines “What is blockchain”:

- 1) *The blockchain is a digital ledger that keeps a record of all transactions taking place on a peer-to-peer network.*

That would mean the ROC, the corporate service provider and all interested stakeholders of a company will get on the blockchain. This will include the government who will create not only the framework but also invest in the system.

- 2) *It is decentralized so there's no need for any central, certifying authority.*

All the parties will create a set of rules on the blockchain, once they are met and meet the legal requirements of setting up a company they are automatically confirmed. For example a passport is keyed in and a scan copy is uploaded and will be verified by Passport Scan Recognition and automatically corroborated with the keyed in data entered into the CRM system of the ROC – this method is already used by many gaming companies to verify accounts and is in compliance with the latest AML rules. All the step by step process to register a company can be put on the blockchain replicating the exact system. However at the time of writing, the current ROC online system does not allow you to upload documents – meaning that passports, utility bills and other relevant documents need to be sent electronically via email and they are then through human intervention relayed to the desk officer, or else the service provider needs to visit the department and present documents in paper form. All this process can be completely eliminated with the use of advanced technologies incorporated in the distributed ledger platform.

- 3) *All information transferred via blockchain is encrypted and every occurrence recorded, meaning it cannot be altered.*

This means that the ROC would become fool proof and less susceptible to data hacks, such as ‘Malta Leaks’ found in the Paradise Papers⁶ which is just a replica of our ROC online database. Furthermore blockchain would substantially reduce human error at user level or desk officer stage because every modification to the blockchain would be audited prior to be accepted (if it fits the rules) and all concerned parties notified – accountability reigns supreme and potential legal blunders avoided.

⁶ AN ICIJ INVESTIGATION PARADISE PAPERS: SECRETS OF THE GLOBAL ELITE
<https://www.icij.org/investigations/paradise-papers/> last accessed 15th April 2018

- 4) *Encrypted information can be shared across multiple providers without the risk of a privacy breach.*

This essentially means that other government departments and agencies can have access to the blockchain to obtain data needed. For example the VAT department will have all due diligence documents – there is no need to do a new application to obtain a VAT number. Even third parties can access the data, such as banks so that it facilitates the opening of a bank account – the banks also have a guarantee that the blockchain is always in possession of the latest data, the distributed ledger platform will remind the user to update KYC documents and in turn the bank is notified when a document that is of interest is modified or updated. The life of the company is on the blockchain, and all parties (but not limited to) referred to in the following diagram can be given an access to the distributed ledger platform and extract data freely based on their rights of access.



Diagram: Once on the blockchain different departments that can be connected or provided automatic information once a company is registered.

- 5) *It can be used for much more than the transfer of currency; contracts, records and other kinds of data can be shared.*

The ROC can monetize on this project. If the Maltese government can create a stable token such as the Tether token (<https://tether.to/>) and peg it to a stable currency. The government can create a 'Maltacoin'⁷ and peg it to the Euro and use this token to monetize by starting to accept crypto payments. This would not be limited to the ROC but can be extended to all governmental services including the collection of tax and social security payments in the form of virtual currencies. All parties related to this project will then be able to convert these tokens to another token or fiat currency of their choice by means of licensed exchanges.

I have limited myself to explain how the ROC can go on the blockchain

⁷ Name is fictitious.

but obviously imagination can go beyond limits, the ROC would be just one platform that uses the Distributed Ledger Technology, the beauty of it is that any government department can use the same blockchain for any service. But not only, any private enterprises can participate in this and I will explain how.

If the government can manage to create one large Initial Coin Offering (of say at least Eur 2bn in value – Eur 1bn to be issued to locals (in the same way as government bonds are issued but won't be classified as a debt as its not repayable) and raised immediately in favour of the government by selling it to the locals who can keep it as a store of value, convert it by investing in other crypto currencies or use it as a means of payment, whilst the second or more billions of tokens are created as needed in unlimited supply as to when services are rendered – such as issuing of taxes, sale of passports, stamp duties, vat on sales etc). Literally the government can create a second new economy run exclusively on the blockchain. The government is to act as a market maker and guarantee the price is always fixed at Eur 1 is to 1 coin. This will give a sense of stability and ease of price comparison. So when the system is in place one can go to the restaurant and pay a coffee in cash, by credit card or by crypto. On the other hand, the restaurant that accepts crypto agrees to do it on the governments ledger (and the government will collect an advantageous Digital Final Withholding Tax on all crypto sales) in such a way that this tax goes immediately to the government via smart contract agreement between restaurant and government's distributed ledger technology. The government will act as an escrow/merchant and he will receive the money from the sales and redistribute instantly to the businessman. Government does not have to chase to collect taxes after two years, and the businessman can decide to choose his proceeds to be paid either in crypto or fiat money (in the latter case the government will use approved platforms and banks to convert the crypto to fiat money and pay the business).

The newly created money (crypto) supply which will be easily transferred will be equivalent to MO it will be available to the public and the distributed tokens will be backed by the Central Bank of Malta will provide a sense of security to potential token holders and will allow it to be widely accepted by merchants not only locally but internationally. I must reiterate the importance of this to be pegged to the Euro so that the price remains stable and it can start being used as a means of payment. At the time many people are sceptical of the use of crypto because prices fluctuate so much as most of the coins and tokens issued are simply bought for speculative purposes.

Returning back to the registration of companies on the blockchain - Dr Galea noted that the current system would not make a token AML compliant⁸. However this is being addressed in the latest Consultation Paper on the Financial Instrument Test – issued by the MFSA⁹. Indeed by giving Virtual Tokens attributes so that they can be exchanged and transferable for legal tender, bank credit or other DLT assets will open new avenues, whereby the ROC can accept payment by Virtual Tokens, not only of the fees due to it, but also of the initial share capital on the blockchain, all third parties and service providers would be paid that way. Tokens are only released once the service is completed and will remain in the distributed ledger platform in suspense. The government's platform will be the intermediary to many parties and

⁸ The Effect of Bitcoin on Money Laundering Law, Dr J. Galea, May 2015, 4.2 - Does BTC satisfy the requirements of AML policies? p 80.

⁹ Consultation Paper on the Financial Instrument Test – MFSA Ref 04/2018 – Issued 13 April 2018

take a fee for every transaction in such a way that an exchange would do. This would allow the fees earned to help sustain the platform's maintenance. From a legal perspective – the case for disputes goes down drastically because all would have been pre-set and legally agreed. From the lawyer's case, accessing the government's distributed ledger platform will create a set of legal requirements that encompass various directives that have already been mentioned in this paper and the government and the private sector need to work hand in hand to create the correct framework of applicable legal requirements to be able to access this platform since in the case of the ROC, the relationship between parties will be ongoing through the life of the company and not a one-time occurrence. Obviously this system can be replicated to cover other private-public governmental services, such as registration of vehicles, payment of duties upon importation, or notarial services offering registration of contracts on the government's distributed ledger platform including the payment of stamp duties and capital gains taxes to mention just a few very random example. This proves the point that the opportunities are endless and the tasks to create this project are not insurmountable.

The government should not be afraid of crypto currencies because if he can invest to create the ultimate platform everyone can be part of it and if one creates advantageous opportunities for the businessman, the government will actually increment new revenues (by creating a second runaway economy run exclusively on the blockchain) – it is now time for the government to start building its own platform – encourage businessman (locals and foreigners) to use this platform and collect the Digital Final Withholding Tax for those who want to use the government's platform, in a similar fashion as to how farmers are taxed instantly at 3% of turnover for the produce they sell to the Pitkali markets. The farmer's model has been in place for many years and works successfully well, so I do believe the model I propose would be well received by the public in general.

What is happening in our country now, is a game changer episode, like a new big-bang where two legitimate economies could potentially co-exist for the same country, and eventually futuristically speaking the one based on the blockchain will become bigger than the traditional fiat economy and eventually it will dwarf the fiat economy – where at some point in the distant future the fiat economy will eventually become obsolete. The advantage of this new model is that it can attract international business very easily and can grow to huge levels and help Malta get continued foreign direct investment which will be converted to fiat money to be invested in infrastructure investments or reduce public debt and make our country one of the wealthiest nations on earth.

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