Stikeman Elliott

The Virtual Currency Regulation Review

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Chapter 5

CANADA

Alix d'Anglejan-Chatillon, Ramandeep K Grewal, Éric Lévesque and Christian Vieira[1]

I INTRODUCTION TO THE LEGAL AND REGULATORY FRAMEWORK

Canada currently has no comprehensive framework governing the regulation of digital assets. Securities and derivatives regulation has emerged as the main regulatory instrument in Canada and is primarily a matter of provincial jurisdiction. While the securities regulatory framework is largely streamlined and harmonised across Canada, legislative jurisdiction in the area of derivatives is divided between the federal and provincial governments and is significantly more fragmented. Jurisdiction is also exercised by the federal government through federal banking and financial services regulation and anti-money laundering legislation, which requires registration of certain virtual currency exchange or transfer services as money service businesses.

The Canadian Securities Administrators (CSA) is an umbrella organisation of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonise regulation of the Canadian capital markets. While there are no specific rules or regulations for virtual currencies, the CSA has published guidance in the form of a number of staff notices with respect to virtual currencies with a view to addressing rapidly evolving developments in retail crypto markets and adapting the existing regulatory framework to digital assets. The CSA and the investment industry self-regulatory organisation known as the Investment Industry Regulatory Organization of Canada (IIROC) (and, effective 1 June 2023, the Canadian Investment Regulatory Organization (CIRO)) have most recently set out the current framework and proposed approach to regulating this asset class in Staff Notice 21-329 – Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements (Staff Notice 21-329). Staff Notice 21-329 provides an actionable roadmap, building on earlier guidance.[2]

As discussed below, this guidance has been backed by aggressive enforcement action directed against certain global market participants that have failed to engage with the CSA on a path to regulation.

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1 Alix d'Anglejan-Chatillon, Ramandeep K Grewal and Éric Lévesque are partners and Christian Vieira is an associate at Stikeman Elliott LLP.

2 This guidance included the 2019 Consultation Paper 21-402 – Proposed Framework for Crypto-Asset Trading Platforms (the Consultation Paper), Staff Notice 46-307 – Cryptocurrency Offerings, Staff Notice 46-308 – Securities Law Implications for Offerings of Tokens, Staff Notice 21-327 – Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets, and Staff Notice 51-363 – Observations on Disclosure by Crypto Assets Reporting Issuers.

More recently, in the face of significant market volatility and insolvency events involving several global crypto trading platforms, service providers and lenders, the CSA has introduced significantly more stringent conditions for virtual currency retail trading activities in the Canadian market.

II SECURITIES AND INVESTMENT LAWS

Securities regulation in Canada generally governs the distribution and trading of both securities and derivatives. These activities are primarily regulated through the imposition of prospectus requirements, dealer, adviser and investment fund manager registration requirements, and certain requirements imposed upon those operating exchanges, alternative trading facilities or other marketplaces that facilitate trading activities, as well as related reporting and disclosure requirements.

i Applicability of Canadian securities laws to virtual currencies

Virtual currencies may be subject to Canadian provincial securities laws to the extent that a virtual currency is considered a security or a derivative for the purposes of those laws, such as the Securities Act (Ontario) (the Securities Act). The Securities Act defines a security to include, among other things, an investment contract. The seminal case in Canada for determining whether an investment contract exists is *Pacific Coast Coin Exchange v. Ontario (Securities Commission)*,[3] where the Supreme Court of Canada identified the four central attributes of an investment contract, namely:

a an investment of money;
b in a common enterprise;
c with the expectation of profit; and
d this profit is to be derived in significant measure from the efforts of others.

If an instrument satisfies the Pacific Coin test, it will be considered an investment contract and therefore a security under Canadian securities laws.

The application of the Pacific Coin test to virtual currencies is not always straightforward, however. Industry participants have taken the position that proper utility tokens, which have a specific function or utility beyond the mere expectation of profit (such as providing their holders with the ability to acquire products or services) should not be considered securities. This position appears to have been accepted by the CSA and CIRO in the joint consultation paper seeking input on various considerations relating to the potential regulation of virtual currencies.[4] The CSA and CIRO have also acknowledged that it is widely accepted that some of the well-established virtual currency assets that function as a form of payment or

3 *Pacific Coast Coin Exchange v. Ontario (Securities Commission)* [1978] 2 SCR 112, which is itself based on the better known 'Howey Test' set out by the Supreme Court of the United States in *SEC v. WJ Howey Co*, 328 U.S. 293 (1946).

4 Canadian Securities Administrators Staff Notice 46-308 – Securities Laws Implications for Offerings of Tokens (Canadian Securities Administrators, 2018).

a means of exchange on a decentralised network, such as BTC, are not currently in and of themselves, securities or derivatives and have features that are analogous to commodities such as currencies and precious metals.[5]

In assessing whether a particular virtual currency will be considered a security subject to Canadian securities laws, the CSA has generally taken a very broad approach and will consider the substance of the virtual currency over its form.[6] The CSA has outlined a number of considerations in determining whether an investment contract exists. While no single factor is determinative, the CSA has stated that the existence of some or all of the following circumstances may cause a virtual currency to be considered an investment contract:

a the underlying blockchain technology or platform has not been fully developed;
b the token is not immediately delivered to each purchaser;
c the stated purpose of the offering is to raise capital, which will be used to perform key actions that will support the value of the token or the issuer's business;
d the issuer is offering benefits to persons who promote the offering;
e the issuer's management retains a significant number of unsold tokens;
f the token is sold in a quantity far greater than any purchaser is likely to be able to use;
g the issuer suggests that the tokens will be used as a currency or have utility beyond its own platform, but neither of these things is the case at the time the statement is made;
h management represents or makes other statements suggesting that the tokens will increase in value;
i the token has a fixed value on the platform that does not automatically increase over time, or change based on non-commercial factors;
j the number of tokens issuable is finite or there is a reasonable expectation that access to new tokens will be limited in the future;
k the issuer permits or requires purchasers to purchase tokens for an amount that does not align with the purported utility of tokens;
l the token is fungible;
m the tokens are distributed for a monetary price; and
n the token may be reasonably expected to trade on a trading platform or otherwise be tradeable in the secondary market.[7]

A particular virtual currency that meets the criteria of the Pacific Coin test or has certain of the characteristics described in the CSA guidance may be properly considered an investment contract and therefore a security, subject to Canadian securities laws. Similarly, the CSA has generally taken a broad approach and noted that most of the offerings of virtual currencies purporting to be utility tokens that its staff had reviewed involved the distribution of a security, usually in the form of an investment contract.[8] While this guidance predates the proliferation of tokens such as non-fungible-tokens (NFTs), a similarly broad approach may apply. More recently, the CSA has expanded its regulatory approach to cover arrangements

5 Canadian Securities Administrators and Investment Industry Regulatory Organization of Canada, Consultation Paper 21-402 – Proposed Framework for Crypto-Asset Trading Platforms (Canadian Securities Administrators and Investment Industry Regulatory Organization of Canada, 2019) (the Consultation Paper).
6 ibid, footnote 3.
7 ibid.
8 ibid., footnote 4.

that are securities or derivatives because they are crypto contracts, and as discussed below, the consequences of characterisation as a security or a derivative include distribution requirements as well as requirements to be registered as a dealer or marketplace, or both.

Virtual currency offerings in Canada

To the extent that a virtual currency is considered a security or a derivative, the issuance or distribution to the public is subject to prospectus, qualification or similar requirements, or must be effected pursuant to applicable exemptions from prospectus or derivatives qualification requirements.

There are a number of options available for distributing securities in Canada on a prospectus-exempt basis, generally referred to as exempt distributions or private placements. Most of these are harmonised under National Instrument 45-106 Prospectus Exemptions. The CSA has indicated that persons who wish to distribute virtual currencies may do so pursuant to these exemptions.[9]

In recent years, a number of investment funds completed prospectus offerings qualifying the distribution of units of pooled fund vehicles whose underlying investments are cryptoassets such as BTC and ETH. The first such offering was completed by 3iQ for its Bitcoin Fund in April 2020 and then in December 2020 for the Ether Fund. CI Galaxy Bitcoin Fund, managed by CI Asset Management and Bitcoin Trust, managed by Ninepoint Partners LP were also launched in December 2020 and let to a number of similar offerings of crypto-based ETFs (for further details see Section II.i 'Asset management and investment funds' below).

ii Regulatory considerations for platforms, exchanges and other intermediaries

Regulation of crypto contracts

The guidance set out in Staff Notice 21-327 – Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets (Staff Notice 21-327) further expands upon the circumstances in which the CSA will consider 'any entity that facilitates transactions relating to cryptoassets' to be subject to securities legislation requirements relating to platform recognition and dealer registration (discussed below). In particular, the CSA cautioned that securities legislation may also apply to platforms that facilitate the buying and selling of cryptoassets, including cryptoassets that are commodities, because the user's contractual right to the cryptoasset may itself constitute a derivative. This will generally be the case where the platform is determined to be merely providing users with a contractual right or claim to an underlying cryptoasset, rather than immediately delivering the cryptoasset.

While regulators will consider all the terms of the relevant contract or instrument, the CSA has taken the view that if there is no immediate delivery of the cryptoasset, then securities legislation will generally apply.

Immediate delivery will be considered to have occurred if:

a there is immediate transfer of ownership, possession and control of the cryptoasset and the user is free to use, or otherwise deal with, the cryptoasset without any further involvement with, or reliance on the platform or its affiliates, and the platform or any affiliate retaining any security interest or any other legal right to the cryptoasset; and

9 Canadian Securities Administrators, Staff Notice 46-307 – Cryptocurrency Offerings (2017), 40 OSCB 7231 (Canadian Securities Administrators, 2017) ('Staff Notice 46-307').

b following the immediate delivery, the user is not exposed to insolvency risk (credit risk), fraud risk, performance risk or proficiency risk on the part of the platform.

Other factors to be considered include:

a contractual arrangements between the platform and the user;
b immediate settlement of transaction;
c margin and leverage trading;
d typical commercial practice with regards to immediate delivery;
e immediate transfer to a user's wallet; and
f ownership, possession or control over the transferred cryptoasset.

Dealer registration

Another consequence of treating a particular virtual currency as a security or derivative under Canadian securities laws is the triggering of a registration requirement. Any person or company engaging in, or holding themselves out as engaging in, the business of trading or advising in securities and, in certain Canadian jurisdictions, in derivatives, must register as a dealer or as an adviser or, where available, conduct these activities pursuant to an exemption from the dealer or adviser registration requirement under the applicable securities or derivatives laws. A person or entity that directs the business, operations and affairs of an 'investment fund' must comply with the investment fund manager registration requirement or obtain an exemption from that requirement (see below).

In Canada, the requirement to register as a dealer or adviser is triggered where a person or company conducts a trading or advising activity with respect to securities or derivatives for a business purpose. The mere holding out, directly or indirectly, as being willing to engage in the business of trading in securities may trigger the requirement to register as a dealer. In the context of virtual currency distributions, the CSA has focused on the following additional factors in determining whether a company may be considered to be trading in securities for a business purpose:

a soliciting of a broad range of investors, including retail investors;
b using the internet to reach a large number of potential investors;
c attending public events to actively advertise the sale of a virtual currency; and
d raising a significant amount of capital from a large number of investors.

Following the regulatory approach outlined in Joint CSA/IIROC Staff Notice 21-329, a number of domestic platforms have been granted restricted dealer registration while other domestic and global platforms continue to engage with CSA members with a view to being appropriately regulated.[10]

Exchanges and other platforms

As marketplaces, exchanges are regulated pursuant to their applicable provincial securities statutes, as well as National Instrument 21-101 Marketplace Operation (NI 21-101), National Instrument 23-101 Trading Rules (NI 23-101) and their related companion policies.

10 See Registered crypto asset trading platforms, Ontario Securities Commission (OSC).

Exchanges or other platforms that facilitate the purchase, transfer or exchange of virtual currencies that are considered securities or derivatives may be subject to recognition requirements as securities or derivatives exchanges, marketplaces or alternative trading systems.

Staff Notice 21-329, issued on 29 March 2021, provided a two-year path to transition into the Canadian regulatory framework for both domestic and global platforms that had admitted Canadian-resident users.

Platforms that trade crypto contracts and trade or solicit trades for retail investors are expected to apply for registration as investment dealers or recognition as exchanges and become members of CIRO. Initially, platforms had been able to access a two-year transitional interim period process by seeking 'restricted dealer registration', subject to not offering leverage or margin trading, pending the ramp-up to full investment dealer registration and compliance. During that period, applicant platforms were expected to undergo an in-depth regulatory review of trade flows, financial controls and auditing, custody, valuation, insurance, market integrity, cybersecurity and risk management.

In CSA and IIROC Joint Staff Notice 21-330 Guidance for Crypto-Trading Platforms; Requirements relating to Advertising, Marketing and Social Media Use issued in September 2021, the regulators also provided requirements, best practices and examples with respect to advertising, marketing, social media activities, fee disclosure and other compliance matters for crypto-trading platforms under Canadian securities legislation.

In 2022, significant market volatility and liquidity issues impacting the broader industry led the CSA to introduce a series of additional measures to tighten the conditions for domestic and foreign platforms seeking registration to operate in the Canadian retail market.[11] Expanded commitments were initially imposed in the form of pre-registration undertakings (PRUs), including enhanced governance, risk management, operational, custodial, insurance, financial reporting and other compliance and reporting requirements.

On 22 February 2023, the series of insolvencies leading to further upheaval in global crypto markets, including Voyager Digital, Celsius Network, FTX, BlockFi and Genesis Global, prompted the CSA to further restrict operating conditions for platforms seeking registration in Canada.[12] Expanded PRU commitments covered more stringent custody and segregation requirements, prohibitions on pledging, hypothecating or otherwise using custodied assets, new commitments for controlling minds and global affiliates, excluding proprietary tokens from the calculation of regulatory capital, enhanced and more frequent financial reporting, enhanced Chief Compliance Officer (CCO) requirements, and a prohibition on enabling trading in 'value-referenced cryptoassets' (commonly referred to as stablecoins) and crypto contracts based on proprietary tokens except with the prior written consent of the CSA.

Platforms that were unable or unwilling to provide an enhanced PRU or implement the necessary systems changes within 30 days of the publication of Staff Notice 21-332 (i.e., by 24 March 2023) were expected to take appropriate steps to identify and off-board existing users in Canada, restrict trading access to Canadian-resident users and provide periodic reporting to the CSA. Only a limited number of global platforms executed and delivered

11 'Canadian securities regulators expect commitments from crypto trading platforms pursuing registration' (CSA, 15 August 2022) and 'CSA provides update to crypto trading platforms operating in Canada' (CSA, 12 December 2022).

12 CSA Staff Notice 21-332 Crypto Asset Trading Platforms: Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection (Staff Notice 21-332).

PRUs to the CSA by that deadline. Others began the process of offboarding Canadian-resident users in consultation with the CSA, including Binance which announced its decision to discontinue its registration process and withdraw from the Canadian market, citing tougher regulation (including restrictions on stablecoin trading) that made its continued operation in the Canadian market 'no longer tenable'.

Asset management and investment funds

Until the recent turmoil in global crypto markets, demand for economic exposure to virtual currencies had been high in Canada and investment funds have been a popular vehicle for obtaining this exposure. However, persons operating or administering collective investment structures that hold or invest in virtual currencies may also be subject to investment fund manager registration requirements in addition to dealer, adviser and prospectus or private placements requirements. The structures themselves may also be subject to product qualification, reporting and conduct requirements that apply to investment funds.

Canada has been at the forefront of regulatory and market breakthroughs in the retail crypto fund space. In 2020, Canada's 3iQ launched North America's first major exchange-listed Bitcoin and Ether funds. In 2021, Canada's Purpose Investments obtained approval from the CSA for the world's first actively managed crypto-based exchange-traded fund (ETF). The CSA has since registered several managers of pooled investment vehicles and approved a number of retail closed-end funds and ETFs investing in virtual currencies through direct holdings of Bitcoin and Ether (including through fund of fund structures).

As with other areas of crypto-related oversight, the CSA have outlined their regulatory expectations with respect to public investment funds holding cryptoassets ('public cryptoasset funds') in light of recent crypto market events. This guidance includes compliance with the regulatory framework generally applicable to publicly distributed investment funds in Canada, the market characteristics of portfolio cryptoassets, liquidity, valuation and custodial practices, issues relating to staking and other high-yield generation activities, and know-your-client, know-your-product and suitability requirements. The CSA guidance notes that as of 30 April 2023, there were 22 public cryptoasset funds in Canada that collectively had approximately C$2.86 billion in net assets.[13]

III BANKING AND MONEY TRANSMISSION

The provision of banking services in Canada is subject to generally applicable federal banking legislation which regulates both Canadian banks and the cross-border activities of foreign banks. The term 'foreign bank' is broadly defined under the Bank Act (Canada) and includes, among other things, any foreign entity that engages in the business of lending money and accepting deposit liabilities, and any foreign entity that engages, directly or indirectly, in the business of providing financial services and is affiliated with another foreign bank. The Bank Act (Canada) provides that, except as permitted, a foreign bank or an entity associated with a foreign bank shall not, in Canada, engage in or carry on any business or maintain a branch in Canada for any purpose.

13 CSA Staff Notice 81-336 Guidance on Crypto Asset Investment Funds that are Reporting Issuers (6 July 2023).

Whether the conduct of crypto-related activities in Canada would be regarded as constituting the carrying on of business in Canada for federal banking purposes is a facts and circumstances-driven determination and will depend on, among other things, where an account (if any) is held, where related contracts are signed and what activities (if any) the foreign bank and associated entities would be performing in Canada.

As noted below, the Office of the Superintendent of Financial Institutions (OSFI), the federal financial services regulator, among other federal agencies, has increased supervision of how federally regulated financial institutions are managing risks associated with crypto-related activities.

The Bank of Canada, which will oversee the application of the new Federal Retail Payment Activities Act, has recently published consultations on a digital dollar.

In addition to federal banking legislation, there is provincial legislation that regulates deposit-taking activities by entities that are not licensed as banks in Canada. While this legislation differs from province to province, provincial trust and loan or trust and savings legislation in many provinces generally requires that entities which accept or receive deposits from the public in that province, in certain circumstances, (1) constitute a loan or savings company under federal or provincial legislation, and (2) register in that province to act as a loan or savings company.

Money transmission is discussed under Section IV.

IV ANTI-MONEY LAUNDERING

Under the federal Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Canada) (the PCMLTFA), any entity that is engaged in the business of foreign exchange dealing, money transferring, issuing or redeeming money orders, traveller's cheques or similar instruments or dealing in virtual currency and any entity that holds a permit, licence or registration related to any of the above mentioned services, must be registered in Canada as a money services business (MSB). Any entity that does not have a place of business in Canada, holds an MSB or similar permit, licence or registration in a jurisdiction other than Canada and directs at and provides to persons or entities in Canada the above-mentioned services, must also be registered as a foreign money services business (FMSB). Both domestic and foreign MSBs are subject to reporting, record-keeping, KYC and compliance requirements under the PCMLTFA.

The activities that are considered 'dealing in' virtual currency are not specifically defined in the legislation. However, guidance published on FINTRAC's website clarify that these activities include virtual currency exchange services and virtual currency transfer services, with a view to regulating entities such as virtual currency exchanges, and not individuals or businesses that use virtual currency for buying and selling goods and services.[14] A 'virtual currency exchange transaction' is defined in this guidance as an exchange, at the request of another person or entity, of virtual currency for funds, funds for virtual currency or one virtual currency for another. Virtual currency transfer services include transferring virtual currency at the request of a client or receiving a transfer of virtual currency for remittance to

14 The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) is Canada's financial intelligence unit and is responsible for monitoring compliance, enforcement and registration under PCMLTFA. The FINTRAC guidance can be found here: https://www.fintrac-canafe.gc.ca/msb-esm/intro-eng.

a beneficiary. Persons and entities that are 'dealing in virtual currency' include domestic or foreign MSBs. A business is also considered to be an MSB if it holds a permit or licence related to any of the above regulated services, it is registered as someone offering any of these services or it advertises that it engages in these services. A person or entity that does not have a place of business in Canada, is licensed or registered in a foreign jurisdiction in a category similar to an MSB, directs its services at persons or entities in Canada and provides services to clients in Canada will also need to be registered as an FMSB under the PCMLTFA. FINTRAC provides guidance on what is considered 'directing services' at persons or entities in Canada:

a the business's marketing or advertising is directed at persons or entities located in Canada (for example, in Canadian newspapers and on websites aimed at clients in Canada or through emails to persons in Canada promoting its virtual currency services);
b the business operates a '.ca' domain name; or
c the business is listed in a Canadian business directory.

However, the FINTRAC guidance also provides that even if none of the above criteria apply, it is still possible that a business is directing services at persons or entities in Canada and a combination of additional criteria should also be considered to make such determination, such as:

a describing services as being offered in Canada;
b offering products or services in Canadian dollars;
c making customer service support available in Canada;
d seeking feedback from clients in Canada; and
e having another business in Canada promote its services to clients in Canada.

The above criteria are not exhaustive and apply regardless of whether a Canadian person or entity to whom the services are directed is an individual or an institutional client. As long as the described activities are directed to and performed for a person or entity that has an address in Canada, whose document or information used to verify the client's identity is issued by a Canadian province or territory or by the federal government or whose banking, credit card or payment processing service is based in Canada, an entity registered in a foreign jurisdiction as an equivalent of a money service business or performing such activities (or both) must be registered as an FMSB in Canada. The registration would also trigger ongoing know-your-client, transaction reporting, record keeping and compliance requirements under the PCMLTFA.

Canadian federal law also includes other laws and regulations regarding anti-money laundering, terrorist financing and use or handing of proceeds of crime, as well as the adoption and enforcement of various sanction regimes. Canadian sanctions and other restrictions may provide additional monitoring and reporting obligations and prohibitions, including offences such as knowingly collecting or providing funds to terrorist organisations or individuals associated therewith, or dealing with otherwise sanctioned governments, entities or individuals. These restrictions and requirements generally apply to persons in Canada and Canadians outside of Canada.

The Money-Services Businesses Act (Québec) (the QMSB) also requires MSB registration with Revenu Québec, the taxation authority in that province. On 29 March 2023, the British Columbia government introduced legislation which will similarly require money services businesses to register provincially the BC Financial Services Authority.

V REGULATION OF EXCHANGES

Regulation of exchanges is discussed under 'exchanges and other platforms' in Section II.

VI REGULATION OF MINERS

The process of virtual currency mining, which utilises specialised, high-speed computers, is energy-intensive. Canada's cold temperatures and low electricity costs have made it particularly attractive for virtual currency miners.[15] While virtual currency mining is not specifically regulated in Canada at this time, the use of virtual currency mining hardware and the increased demand for electricity have led to a number of targeted provincial and municipal government measures. On 9 March 2022, for example, the Ontario Ministry of Energy proposed regulatory amendments to Ontario Regulation 429/04 that would prevent facilities that engage in cryptocurrency mining from participating in the Industrial Conservation Initiative (ICI).[16] The Quebec government has also recently stepped up pressure on Hydro Québec, the province's hydroelectric utility, to eliminate the 270MW that had been allocated to blockchain projects in the face of crypto-related consumption expected to exceed 3TWh by winter 2024.[17]

VII REGULATION OF ISSUERS AND SPONSORS

Regulation of issuers and sponsors is discussed under 'Virtual currency offerings in Canada', 'Regulatory considerations for platforms, exchanges and other intermediaries' and 'Asset management and investment funds' in Section II.

VIII CRIMINAL AND CIVIL FRAUD AND ENFORCEMENT

Application of Canadian securities regulation is triggered where the activity itself is carried out from a Canadian jurisdiction, and where the product or service is available to Canadian users (through the internet or otherwise). Canadian securities regulators also have a public interest jurisdiction to exercise authority in respect of conduct that may not technically breach any securities laws but is considered to be against the public interest. The regulators are more likely to exercise this jurisdiction in circumstance where there is risk of fraud or market manipulation or material risks to retail investors, including the indirect facilitation of activity that is considered unlawful or carried out by unregulated entities, or both.

Starting in 2020, the CSA has been more aggressive in its pursuit of crypto platforms and other participants that they view as disregarding the application of Canadian securities laws. CSA actions have included publications of names on investor warning lists in pursuit of enforcement actions. For example, in July 2020, Coinsquare Ltd and its executives were ordered to pay over C$2.2 million in sanctions after admitting to engaging in market manipulation by reporting inflated trading volumes, misleading clients about the suspect

15 Ontario Regulatory Registry, Industrial Conservation Initiative Cryptocurrency Mining Exclusion, 23 March 2022.

16 Naomi Powell, 'Crypto-miners flood into Canada, boosting the hopes of small towns looking for a break', *Financial Post*, 23 June 2020.

17 *Le Devoir*, Hydro-Québec frein la filière crypto, 3 November 2022.

volume and retaliating against a whistleblower. This represented the OSC's first enforcement case against a virtual currency trading platform. On 29 March 2021, the OSC issued a press release concurrent with Staff Notice 21-329 urging crypto trading platforms that offered trading in derivatives or securities to persons or companies located in Ontario to contact OSC staff by 19 April 2021, to discuss how to bring their operations as a dealer or marketplace into compliance, failing which the OSC would take steps to enforce applicable requirements under securities law.

Subsequent to the issuance of Staff Notice 21-329, the OSC commenced enforcement actions against a number of entities, alleging, according to the statements of allegations in these cases, that these entities failed to commence the process for complying with registration rules and disclosure requirements for distributions by the 19 April 2021 deadline specified in its press release on Staff Notice 21-329.

IX TAX

i Taxation of virtual currencies

For Canadian tax purposes, the Canada Revenue Agency (CRA) has taken the position that virtual currencies constitute a commodity rather than a currency.[18] As such, gains or losses resulting from the trade of virtual currencies are taxable either as income or capital for the taxpayer.[19] Whether a transaction is on the account of income or capital is a question of fact and is determined by the CRA through an examination of the nature of the transaction in question.

Where a transaction is considered on capital account, the taxpayer will be required to include in computing its income for the taxation year of disposition one-half of the amount of any capital gain (a taxable capital gain) realised in that year. Subject to and in accordance with the provisions of the Income Tax Act (Tax Act),[20] the taxpayer will generally be required to deduct one-half of the amount of any capital loss (an allowable capital loss) realised in the taxation year of disposition against taxable capital gains realised in the same taxation year. Allowable capital losses in excess of taxable capital gains for the taxation year of disposition generally may be carried back and deducted in any of the three preceding taxation years or carried forward and deducted in any subsequent taxation year against net taxable capital gains realised in those taxation years, to the extent and under the circumstances specified in the Tax Act. Where a transaction is considered on income account, the resulting gains are taxed as ordinary income and the losses are generally deductible.

Recently, the CRA published a tax tip stating that taxpayers should keep proper financial records of all of their cryptocurrency transactions, including when they purchase, dispose or mine cryptocurrency.[21]

18 Canada Revenue Agency, Document No. 2013-0514701I7, 23 December 2013.

19 Canada Revenue Agency, Fact Sheets & Taxpayer Alerts, What You Should Know About Digital Currency, 17 March 2015.

20 Canada Revenue Agency, Compliance, Virtual Currency, last modified 26 June 2019.

21 Income Tax Act, RSC 1985, c.1. Canada Revenue Agency, 'Keeping records of your cryptocurrency transaction', 27 March 2023.

ii Virtual currency mining

The tax treatment of virtual currency mining will depend on whether the activity is undertaken for profit or as a personal endeavour.[22] A personal endeavour is an activity undertaken for pleasure and does not constitute a source of income for tax purposes, unless it is conducted in a sufficiently commercial and business-like way. However, the mining of virtual currencies is likely to be considered a business activity by the CRA considering the complexity of the activity. The mining of virtual currencies would therefore require the taxpayer to compute and report business income in compliance with the Tax Act, including the rules with respect to inventory.

More precisely, the CRA has stated that Bitcoin received by a miner to validate transactions is consideration for services rendered by the miner.[23] Where a taxpayer is in the business of Bitcoin mining, the Bitcoin received must be included in the taxpayer's income at the time it is earned. The CRA confirmed that the miner must bring into income the value of the services rendered or the value of the Bitcoin received, whichever is more readily valued; in most cases, the CRA expects the value of the Bitcoin received to be more readily valued and, accordingly, this is the amount to be brought into income.[24]

iii Paying with virtual currencies

Where a virtual currency is used as payment for salaries or wages, the amount must generally be included in the employee's income computed in Canadian dollars.[25] As a result of the qualification of virtual currencies as a commodity, the use of virtual currencies to purchase goods or services is subject to the rules applicable to barter transactions. Therefore, where virtual currencies are used to purchase goods or services, the value in Canadian dollars of the goods or services purchased must be included in the seller's income for tax purposes, rather than the value of the virtual currencies.[26] However, the CRA has stated that the fair market value of the virtual currency at the time the supply is made must be used to determine the goods and services tax and harmonised sales tax (GST/HST) payable on the purchase of a taxable supply of a good or service.[27]

iv Specified foreign property

The CRA has finally stated that virtual currencies situated, deposited or held outside Canada fall within the definition of specified foreign property, as defined in the Tax Act.[28] As such, Canadian residents must report to the CRA when the total costs of virtual currencies situated, deposited or held outside Canada exceed C$100,000 at any time in the year by filing Form T1135 with their income tax return for the year. The question remains of the situs of virtual currencies. The CRA has not adopted a position yet and the issue is currently under review.[29]

22 Canada Revenue Agency, Document No. 2014-0525191E5, 28 March 2014.
23 Canada Revenue Agency, Document No. 2018-0776661I7, 8 August 2019.
24 ibid.
25 Canada Revenue Agency, Compliance, Virtual Currency, last modified 26 June 2019.
26 ibid., footnote 113.
27 ibid.
28 Canada Revenue Agency, Document No. 2014-0561061E5, 16 April 2015.
29 Canada Revenue Agency, Document No. 2022-0936241C6, 7 October 2022.

v Collection of goods and services tax and harmonised sales tax with respect to virtual currency transactions

The exchange of cryptocurrency is no longer considered a sale of an asset, but a sale of a financial instrument for GST/HST purposes. Section 123(1) of the Excise Tax Act (ETA)[30] includes 'virtual payment instruments' to the definition of 'financial instruments', rendering any sale of or transaction involving virtual currencies as a form of payment exempt from GST/HST collection.

Once again, the Department of Finance sought to clarify the characterisation of cryptoasset activities by introducing Bill C-47, the Budget Implementation Act (Bill C-47) on 20 April 2023 which, among other things, proposes amending the ETA[31] to include cryptoasset mining. With this change, cryptoasset mining would not be considered a supply so GST/HST would not apply to hashpower services and input tax credit would not be available to the person providing the service.

The Department of Finance also proposed in Bill C-47 an amendment to Section 188.2 ETA to expand who is involved in a mining activity to not give rise to an input tax credit. The new section is effective as of 5 February 2022. For instance, the allowance of computing resources from one person to another for the purpose of mining will be considered a 'mining activity'. However, in a situation where the provider of the mining activity is a particular person and the recipient of such activity is known, Subsection 188.2(5) ETA may provide an exception and supplies of such activities would be taxable supplies and expenses.

X OTHER ISSUES

Depending on the specificities of a particular business model and its nexus to the Canadian market, trading, lending and other activities involving crypto contracts may be subject to a range of other Canadian legal requirements that are not specifically described in this chapter but should be considered, including the potential application of federal banking legislation, provincial loan and trust regulation, consumer protection legislation, privacy legislation, proposed new retail payments legislation, Canadian trade and economic sanctions, extra-provincial business registration, advertising and marketing laws, Canadian anti-spam laws and Quebec language laws.

XI LOOKING AHEAD

The roadmap established under Staff Notice 21-329, together with the PRU framework more recently developed by the CSA in response to events in the global crypto market now form the backbone for the regulation of new virtual currency platforms and businesses in Canada. Stringent new qualified custodian and segregation requirements have created a gap in the market and opened up new opportunities for qualified service providers. In July 2021, Tetra Trust Company (Tetra) became the first regulated custodian based in Canada qualified to store digital assets for the purposes of NI 81-102 and NI 31-103.

The collapse in March 2023 of crypto-friendly banks and lenders, including Silicon Valley Bank, Signature Bank and Silvergate Capital, has heighted concerns over increased

30 Excise Tax Act, RSC 1985, c. E-15.

31 Budget Implementation Act, Bill C-47, 1st Session, 44th Parliament, Canada, 2021-2022-2023.

liquidity and financial stability risks, leading to a renewed focus on prudential supervision of cryptoasset exposure of Canadian federally regulated financial institutions and the use of stablecoins.[32]

The early wave of enforcement actions brought against non-compliant platforms will likely be followed by increased cross-border enforcement activity against global platforms that have ignored the up-or-out path to regulation in Canada. However, against the ongoing global race to develop crypto-friendly regulatory hubs, Canada continues to position itself as a tough but pragmatic and credible jurisdiction to establish a virtual currency business, although the size of the Canadian market and the cost-benefit calculus of operating in the Canadian market will continue to drive decisions to commit to Canada over the longer term.

32 See 'Interim arrangements for the regulatory capital and liquidity treatment of cryptoasset exposures' (OSFI, 18 August 2022), 'Statement to entities engaging in crypto-asset activities or crypto-related services' (OSFI, 16 November 2022), 'OSFI launches consultation on fiat-referenced crypto-asset arrangements and activities' (OSFI, 17 April 2023).

About Stikeman Elliott

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