

## THE LEGAL REGIME FOR CRYPTOCURRENCIES IN KAZAKHSTAN AND IMPOSSIBLE CONTROL OF THEIR CIRCULATION

FARHAD KARAGUSOV<sup>1</sup>, ALEXEY BONDAREV<sup>2</sup>

### Abstract

*Development of a legal framework for cryptocurrencies in Kazakhstan is described in this article: from very first steps in 2018 when financial intermediaries were just warned from use of Bitcoins and alike in their transactions to prohibition of their circulation established into 2020, with cancellation of the prohibition and strengthening regulation of crypto mining in 2023. Authors show that neither existence nor absence of a legislative restriction of cryptocurrencies' circulation can help the State to control respective turnover. Respectively, no efficient solution can be said existing to both support a public order and protect individual property rights to cryptocurrencies.*

**Keywords:** Republic of Kazakhstan, cryptocurrency, Law on Informatisation, digital assets, AIFC, digital mining, regulation, legal framework.

### I. Introduction

Kazakhstan's legislative system does not operate the notion of cryptocurrency as a legal term. However, the legal framework exists for certain objects which in essence fall under the common understanding of cryptocurrencies.

Respective legal regime for such objects (i.e. cryptocurrencies) in Kazakhstan was introduced recently, not earlier than 2018. Three stages of its development can be identified until now.

The first stage represented efforts, first operational and later regulatory, of the National Bank of the Republic of Kazakhstan (the "NB RK"). Thus, in February 2018, the NB RK circulated a letter among local financial organisations insisting to abstain from any transactions with cryptocurrencies [9]. The position of the NB RK rests on the fact that Tenge as the national currency of Kazakhstan is the only legal tender in the country [28]. Further, in 2018, the NB RK prohibited banks and banks' employees to engage into any transactions with cryptocurrencies, restricted payments for shares to be made by cryptocurrencies and prohibited dealers and brokers from dealing with financial instruments which value is defined as cryptocurrencies.

The second stage was associated with the legislative introduction of the notion of digital assets as a legal term and prohibition of circulation of cryptocurrencies in Kazakhstan. However, the legal framework for cryptocurrencies remains controversial and requires significant improvements.

As a third, current, stage we can identify as a one which started earlier in 2022 with an attempt to clarify the legal framework for digital assets in Kazakhstan. As of the end of November 2022, such efforts have not been completed yet. However, on 29 November 2022, a press release was made with the information that the Parliament of Kazakhstan has passed a package of laws aimed at regulating digital mining and "creating a cryptocurrency ecosystem in Kazakhstan" [36]. Such legislative amendments require signing respective laws by the President of Kazakhstan before the laws shall be published and come into effect. Therefore, we cannot know the final wording of the laws, but refer to the information given in the Press Release.

### II. Definition – Legal Qualification

Neither regulations of the NB RK nor a legislative act of the Republic of Kazakhstan (the "RK") use and define a term "cryptocurrency". Though, this term is widely used in daily life and informal communications.

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<sup>1</sup> Leading scientific fellow at the Institute of Private Law of Caspian University in Almaty, Kazakhstan / email: fsk2906@gmail.com

<sup>2</sup> Consultant at K&T Partners LLP (TOO «Кей энд Ти Партнерс») in Almaty, Kazakhstan

In relation to cryptocurrencies, the NB RK regulations operate two notions of similar meaning. The first one is the legal term “digital (virtual) units” [tsifrovaya (virtual’naya) yedinitsa] [32]. The second notion we can name, for the purpose of economy of words, as “value units” [34]. Both of the notions are similarly defined as “a digital record created and recorded in a decentralized information system with application of cryptography methods and (or) computer calculations”, but the second one is additionally qualified as not being “financial instruments” or “financial assets” (as those terms are defined by the RK Civil Code) and not representing someone’s right to claim.

At the same time, the RK Civil Code (Article 115 (2)) and the Law on Informatisation (Article 33-1) use the term “digital assets”. The Law on Informatisation classifies them into two categories: “secured digital assets” and “unsecured digital assets” [26]. Secured digital assets represent a digital legal form (certification method) of a certain type of property rights with respect to goods and services. Their legal regime can be compared with the one of certified securities which are simultaneously considered as a type of certain property and a qualified form of certification of respective property rights. Respectively, cryptocurrencies, like Bitcoin, cannot be recognized as secured digital assets under Kazakh law.

Unsecured digital assets are defined as “digital tokens received as a reward for participation in maintaining consensus in a blockchain in accordance with a procedure established in the legislation of the Republic of Kazakhstan” (Article 33-1 (2) of the Law on Informatisation).

Obviously, the aforementioned NB RK regulations and the Law on Informatisation define both terms, the digital (virtual) units or value units, on the one hand, and unsecured digital assets, on the other hand, with different words but similar in essence. Both definitions cover cryptocurrencies, because they generally correspond to a global understanding of cryptocurrencies as tokens which are rewarded to a person for participation in consensus algorithms [7]. Therefore, under Kazakh law cryptocurrencies, like Bitcoin, are subject to the legal regime of unsecured digital assets, and not of secured digital assets.

No cryptocurrency has been legislatively recognized as legal tender in Kazakhstan.

### *III. Regulatory Framework*

The Law on Informatisation clearly prohibits issuance and circulation of unsecured digital assets within the RK territory. Thus, such rule expressly prohibits the circulation of cryptocurrencies in Kazakhstan’s legal system. This prohibition means that derivatives referencing cryptocurrencies are also prohibited in Kazakhstan.

Such prohibition is of a common nature and applies for any person whether it is a resident or non-resident of the RK, individual or legal entity, etc.

It is obvious that the RK, as many other States, finds unsecured cryptocurrencies such as Bitcoin, all of the alternative coins (ETH, LTC, BCH and etc.) as well as stable coins (USDT, BUSD, USDC and etc.) as a high-risk and unwelcomed investment opportunities and instruments which may threat and harm the financial well-being of the RK citizens.

However, the Law on Informatisation provides for certain exceptions from this prohibition that can be established by legislative acts. But no such exceptions exist at this moment. We assume, however, that certain reservations are made for a business within the Astana International Financial Centre (the “AIFC”) [5].

The AIFC is an independent entity within the territory of the RK which is excluded from the RK’s civil, financial and judicial legal regulation and self-governed “based on principles of laws of England and Wales” [22]. But one has to know that due to its such specific status the AIFC cannot be considered as the RK jurisdiction, though it is located in the territory of Kazakhstan [10].

Since the legislative prohibitions for issuance and circulation of cryptocurrencies have been set out, no system and/or infrastructure for issuance and circulation for cryptocurrencies can exist in the RK. Accordingly, no actual or potential legal relationships between different participants to a blockchain on which cryptocurrencies are transferred and recorded can also exist. Although, a controversial exception can be seen in relation to legalization of mining in Kazakhstan (see below).

At the same time, we shall note that in the digital era any prohibition of issuance and circulation of anything having digital form is extremely ineffective without creation of relevant prevention mechanisms. As we know, there are plenty of digital methods which allow both issuance and circulation of cryptocurrencies regardless of such legislative prohibitions. All existing online services, such as launchpads (BSCPad, BullPerks, TrustSwap and etc.), cryptocurrency exchanges (Binance, Coinbase, Kraken and etc.), digital currency exchangers (BitMEX, EXX, OKEx and etc.), cryptocurrency wallets (MetaMask, BitGO, XAPO and etc.) can combine all of the methods in general.

We also know that, by this time, the only effective mechanism ensuring such prohibitions has been created by China where they are able to effectively block access to any use of mentioned methods through the Internet. But they also established and enforced legislative prohibitions for industrial mining of cryptocurrencies.

Different for the RK: (I) mining of cryptocurrencies has been legalized in Kazakhstan and (II) established prohibition of issuance and circulation of unsecured assets (cryptocurrencies) has not been backed by any enforcement mechanism. In addition, such prohibition is not supported by any relevant provision of criminal law or administrative violations law.

Besides, it looks controversial where cryptocurrencies' mining is allowed but the entire infrastructure for their issuance and circulation cannot legally exist due to the aforesaid legislative prohibition of issuance and circulation of unsecured digital assets within the RK territory (and all of the abovementioned online services should be illegal in Kazakhstan).

Another controversy (though not in law, but in practice) can be found in the fact that there were no attempts undertaken to block in the RK any use of such digital methods as mentioned above. Even Binance cryptocurrency exchange which caused legal problems in many jurisdictions throughout 2021 has been always accessible in Kazakhstan [20]. Moreover, for unclear reasons Binance is now present in the AIFC [3], and the NB RK considers integrating the RK's CBDC (digital Tenge) on Binance's blockchain network BNB Chain [8].

Specific anti-money laundering and counter-terrorism financing (the "AML/CFT") provisions applicable to operations with digital assets were introduced into the legislation of the RK. Since January 2022, those entities issuing digital assets, organizing trades with digital assets and exchanging digital assets into money, other values and property are recognised as subject of financial monitoring under the law [24]. As such, they are obliged to conduct know-your-client procedures (KYC) on their clients and report on respective suspicious operations. Currently, respective provisions relate to operations with only secured digital assets because issuance and circulation of unsecured digital assets (cryptocurrencies) are prohibited in the RK.

#### *IV. Supervision*

There is no state or public supervision for cryptocurrencies in the RK.

However, the Law on Informatisation identifies a category of those who must give specific notice to the relevant governmental authority about their activities involving cryptocurrencies. Particularly, before 2022 only miners were obliged to submit such notices (Article 33-1 (9)). But in 2022, issuers of digital assets, organizers of trading with digital assets or providers of services on exchange of digital assets into money, other values and property were also recognized as such notifying persons (Article 33-1 (10)), as well as providers of mining equipment were also set to be the notifying persons but within the same category as miners [30]. Now all of them must submit required notices regarding beginning and termination of their activity.

Nevertheless, until now there are no supervisory measures/actions which are regulated by law and were taken against any of those entities. As the only exception numerous raids can be mentioned which were undertaken by law-enforcement agencies and prosecutors in 2022 to reveal those miners who failed to notify relevant authorities about the start of their activity and which raids resulted in seizure of mining equipment.

In the Law on Informatisation, digital mining is defined as a process of conveying of calculating operations with use of computers, power supplies according to established algorithms of encryption

and data processing ensuring validation of data blocks integrity in the informatisation objects by methods of blockchain (Article 1 (55-3)).

In turn, providing mining equipment means provision of complex computing infrastructure for performing computational operations and data processing [14].

The aforementioned regime of communication provides for specific notice of miners and providers of mining equipment to be given to the authorized state agency which is the RK Ministry of Digital Development, Innovations and Aerospace Industry (the “Ministry”). We understand that this regime was meant to ensure the monitoring function of the State, but we cannot consider it as true monitoring.

Particularly, it is established that digital miners and providers of mining equipment shall inform the Ministry regarding their activity on digital mining in accordance with procedures set forth by the Ministry [14]. The procedure requires that the relevant person shall send a notice regarding its digital mining or mining equipment provision activity to the Ministry. The notice must be submitted before a commencement date of the respective activity. It should include, inter alia, proposed location of the mining data center, volume of electric power to be consumed, name’s indication and quantity of the mining equipment to be used.

Acting digital miners who already operate data centers and providers of mining equipment shall submit quarterly reports which shall include, among others, volume of consumed electrical power, planned investments, quantity of work places for personnel.

Digital miners and providers of mining equipment who consider termination of their activity shall also inform the Ministry regarding shutting down their operations in the RK.

Such existing regulation of digital mining gives rise to, at least, the following two problems.

First of the problems relates to the existence of two major consensus algorithms in the crypto industry which are Proof-of-Work (the “PoW”) and Proof-of-Stake (the “PoS”) algorithms. As it is well known, methods of obtaining new cryptocurrency units (coins) depend on the consensus algorithms applicable to a certain blockchain project. These two (or any other) methods shall be considered as separate ones and cannot be mixed up by legislation as a single method.

Particularly, the PoW consensus process relates to “mining” itself and is performed by complex mathematical calculations using computers, other expensive equipment and significant consumption of electricity which involves validation of transactions in the blockchain. Use of the PoW consensus allows to obtain a relevant reward in form of new digital coins/tokens.

In turn, the PoS consensus known as “staking” needs no significant power consumption because it requires blockchain users to pledge a certain amount of a cryptocurrency to a special wallet. Such pledge grants them a right in validation of transactions in blockchain and the right to obtain a relevant reward in form of new digital coins/tokens.

The definition of “digital mining” existing in the RK legislation is unclear because it can be interpreted as covering both mining and staking. It appears that the RK legislator introduced regulation of digital mining in pursuit to control significant power consumption. In that case, staking should be expressly excluded from the definition of “digital mining” to prevent any misuse of the established rules regarding the notifications of digital mining as described above.

Second problem exists in connection with the fact that digital mining is legalized but circulation of cryptocurrencies is prohibited in the RK. Only secured digital assets can be issued and circulated in the RK, but such cannot be mined as a matter of their nature. Only unsecured digital assets such as Bitcoin, Ether, Litecoin, Bitcoin Cash and similar coins can be subject to mining.

Circulation of any assets/property is regulated by law based on general provisions of the Civil Code according to which civil rights’ objects may be freely disposed or transferred to any person in order of the universal succession (e.g. in case of inheritance or reorganization of a company), or titles and property can be transferred in any other way provided that such objects are not excluded from the circulation or not limited in circulation (Article 116 (1)).

Digital mining may not be attributed to circulation of digital assets. It can be considered only as a ground of emerging civil rights to certain types of objects/assets. Particularly cryptocurrency and rights to cryptocurrency shall be a result of digital mining. Any transfer of cryptocurrency by those

who possess it as a result of such digital mining should cause its ability for circulation which is prohibited under current legal regime. Therefore, mining becomes senseless because it is limited only to holding the unsecured digital assets being mined.

Different from establishing specific notification regime which is mandatory for digital miners and providers of mining equipment, the Law on Informatisation (Article 33-1 (10)) has obliged issuers of digital assets, organizers of trading with digital assets or providers of services on exchange of digital assets on money, values and other property to notify the respective governmental authority about beginning or termination of their activities in accordance with the rules existing in the Law on Permits and Notices [25].

#### *V. Private Law Issues*

Prohibition of the unsecured assets' circulation entails that cryptocurrency cannot be contractually acquired, sold, gifted, otherwise transferred, be subject to attachment, be pledged or lent, as well as a trust or managements with respect to cryptocurrencies cannot be created. In addition, insolvency proceedings and actionable tort regarding loss of cryptocurrencies cannot be established and applied. Besides, because of the legislative prohibition of cryptocurrencies' circulation, it is unclear whether Kazakh courts would recognise unsecured digital assets to be a property possible for inheritance.

One should note that the Law on Informatisation provides that a digital miner becomes an owner of the digital assets produced in the course of digital mining (Article 33-1 (8)). This provision is very controversial because: (I) mining can be applied only in respect to cryptocurrencies (i.e. unsecured digital assets) which (II) cannot be objects of property rights including, among others, ownership rights. In connection with that, the ownership right to cryptocurrencies obtained as a result of mining cannot be implemented in accordance with the law.

This means that the established constitutional guarantee of the ownership right (Article 6 and 26 of the RK Constitution detailed in Article 188 (1) of the Civil Code) does not work with respect to cryptocurrency owned in the result of mining. And such inconsistency with the RK Constitution can serve as a ground to challenge the constitutionality and applicability (at least in this part of the regulation) of the Law on Informatisation.

#### *VI. Tax Measures*

Since 1 January 2022, the RK Tax Code provides for taxation of digital mining activity (Articles 606-1 – 606-5). Special tax shall be paid by miners. An amount of the tax to be paid should be calculated based on a volume of the electrical power consumed for digital mining, i.e. 1 (one) Kazakhstan's Tenge for a kilowatt-hour of electrical power used.

According to amendments made to the RK Tax Code in 2022, from 1 January 2023 the taxation of digital mining will be changed to the way that respective tax rates shall differ depending on the electricity consumed (amended version of Article 606-3). Namely, the starting tax rate will be equal to 25 (twenty five) Kazakhstan's Tenge for up to 1 (one) kilowatt-hour consumed and a gradually decreased rate down to 1 (one) Kazakhstan's Tenge shall apply for more than 24 kilowatt-hour consumed. The tax rate decreasing step shall be equal to 1 (one) Kazakhstan's Tenge for consumption of 1 (one) additional kilowatt-hour.

However, the tax regime shall be different in the case when miners consume their own-generated electric power. Particularly, the following special tax rates shall apply instead of above mentioned rates: (I) 10 (ten) Kazakhstan's Tenge for 1 (one) kilowatt-hour consumed shall be paid by miners using their own electric power and (II) 1 (one) Kazakhstan's Tenge for 1 (one) kilowatt-hour consumed to be paid by miners using their own renewable energy produced in Kazakhstan. However, such special rates shall not apply in absence of electricity metering devices and the maximum tax rate of 25 (twenty five) Kazakhstan's Tenge per 1 (one) kilowatt-hour shall apply.

It is worth mentioning that since the migration of miners from China after the prohibition of industrial mining by Chinese authorities introduced in China in May 2019, the RK became among the top three countries in the world for cryptocurrency mining. Apparently, RK-based mining still has an important

share in global mining. Its importance became obvious during the internet shutdown in the regions of RK during riots of the early January of 2022 which caused a fall of Bitcoin price for about 10% [13].

However, we assume that introduction of the aforementioned tax regime (together with some other reasons, among which the electricity shortage presumably caused by an increased number of digital miners can be mentioned) [12] would cause a number, if not the most, of miners to think leaving the RK, even considering introduction of the tax incentives for the case of use of so called own-produced electricity for digital mining, regardless of whether it is “green” or not.

#### *VII. Litigation in relation to cryptocurrencies*

We are not aware about any completed or still ongoing judicial or arbitration proceedings involving cryptocurrencies in the RK. Searches in publicly available sources did not show any result.

No specific actions or class actions exist for disputes in relation to cryptocurrencies use or services. No special or exclusive heads of jurisdiction are available for cryptocurrencies litigation.

Since circulation of cryptocurrencies is prohibited in Kazakhstan, no disputes and litigations within regulated civil procedures can take place with respect to cryptocurrencies under existing legal regime. As the only exception, a claim for recognition or protection of the ownership right to cryptocurrencies emerged as a result of their mining can be possible under the existing legal regime.

But breach of the prohibition should lead to criminal or at least administrative prosecutions. However, this prohibition does not constitute a legally defined crime or administrative violation and no specific liability for breach of the prohibition has been provided for by the RK legislation at this point.

Nevertheless, we are aware of two criminal proceedings involving cryptocurrencies which took place in 2017 and 2022. First one was initiated by the State against a RK-resident individual who scammed other RK-resident individuals by imitating the selling of Bitcoins to them for a low price. The scammer reimbursed losses (approx. USD 15,000) of his victims and was sentenced to three years of probation [18]. The second one has a similar context but the amount of reimbursed losses comprised approx. USD 280,000 [16]. Given that not all of the judicial and arbitration cases are publicly available in Kazakhstan, we cannot confirm that the mentioned cases are the only ones that have taken place in the RK these days.

As a general rule, as established in the RK Code of Civil Procedures, decisions of foreign courts and arbitral awards can be enforceable by the RK courts if recognition and enforcement of such decisions and arbitral awards is provided by law and (or) international treaty ratified by the RK and or on the basis of reciprocity (Article 501). Kazakhstan is a party to the 1958 New York Arbitration Convention and also it is a party to numerous bilateral and multilateral international treaties concerning recognition and enforcement of foreign courts decisions.

However, the RK courts may reject recognition and enforcement of such decision and arbitral awards if it results in breach of public order of the RK. Since circulation of cryptocurrencies is prohibited in the RK, such recognition and/or enforcement by the RK courts shall likely be impossible.

#### *VIII. Miscellaneous*

A legal theory of cryptocurrency is merely developed in the RK. Very few publications can be noticed to be valuable for development of the theoretical basis of legal regime for cryptocurrencies and, in general, digital assets. In his article, concerning the newly introduced concept of digital assets M. Suleimenov opined that digital assets (without any references to their acknowledged types) represent a form of existence of property rights [19].

In their publication F. Karagusov and A. Bondarev proposed explanation of the term “cryptocurrency”, compared it with concepts of money and electronic money, stressed out specific features of cryptocurrencies which are different from those of fiat money, collated money circulation and cryptocurrencies market, described situation related to use and regulation of cryptocurrencies in Kazakhstan as of beginning of 2020, and concluded that the cryptocurrencies’ circulation cannot be under, at least, full control of the State [9].

Lack of well-developed theoretical considerations of legal nature of cryptocurrencies and neglectfulness of regulators and legislators to the existing scientific elaborations led to creation of an unclear and ineffective legal framework for cryptocurrencies in the RK.

Nevertheless, the following three fields can be identified as directions of current and further development of crypto industry in Kazakhstan: (I) improvement of the existing legal framework for digital assets in RK, (II) understanding of significance and impact on the RK jurisdiction of the existing legal environment for circulation of cryptocurrencies and other digital assets within the AIFC and (III) elaboration of relevant pilot project and introduction of digital Tenge as national currency.

### *8.1. Legal Framework of Crypto Industry in Kazakhstan: background and current state of affairs*

For a long time since the crypto industry appeared and substantially evolved in the RK the State did not try to legally allow or forbid individuals and companies to participate in this industry. First signs of the State's concern in cryptocurrencies appeared in 2018 and coincided with the all-time high of Bitcoin in December of 2017 and forcing of the respective news in the media.

Particularly, in February 2018, the NB RK, in absence of a respective legal framework, started with recommendations to abstain from any transactions with cryptocurrencies which were addressed only to financial institutions functioning in the RK. Despite the recommendatory nature of this position of the NB RK, we are not aware of any precedent where any financial institution ignored that.

That position of the NB RK was based on the acknowledgement of Tenge as the only legal tender in the RK [28]. However, one should note that under the RK Law on Currency Regulations foreign currencies can also serve as legal tender in Kazakhstan under specific and very limited circumstances. For example, settlements between residents and non-residents of the RK can be made in foreign currency.

Here we should mention that this exception allows use of foreign currency but not any of a legal tender recognized in foreign jurisdictions. That means that Bitcoin (accountable only on digital wallets), which is recognised by El Salvador as its legal tender, cannot be available for settlements in Kazakhstan because it is not a foreign currency according to the established legal definition of this term under the RK law (i.e., Bitcoin is not “coins and banknotes as well as money in monetary units of foreign countries [deposited] on bank accounts”).

In October 2018, the NB RK amended its previous Rules on Risk Management System and Internal Control in Banks [29], and later replaced them with the new Rules [33], both of which set forth the prohibition to banks and their employees to engage in any transactions with cryptocurrencies.

In 2018, the NB RK also prohibited payments by any digital (virtual) units and derivatives with underlying digital (virtual) units/assets for shares. The same prohibition was established with respect to indexation of a nominal value and interest rates of bonds in digital assets [32], as well as circulation of financial instruments whose price depends on cryptocurrency's price [17].

Also since 2018 securities brokers and dealers as well as managers of investment portfolios have been prohibited to enter into transactions with derivatives where a price depends on the values created and recorded in decentralized systems [35, 36, 37].

Consequently, in absence of any clear conceptual approaches for a legal framework of cryptocurrency the NB RK took a position of prevention of crypto industry's invasion to the financial market of the RK.

This approach allowed the RK to postpone a development of a legal framework for cryptocurrencies and to mitigate the risk of massive involvement of the unqualified private investors into the high volatility assets.

Two years later, in 2020, the RK introduced the first set of national regulation of cryptocurrencies which consists of relevant amendments to the Civil Code and the Law on Informatisation as well as creation of some supportive regulations [31].

As mentioned above, the broader term “digital assets” is used as the main concept of the new legal framework instead of use of the notion “cryptocurrencies”.

In the Civil Code, the term “digital assets” is recognized as a separate type of material goods and other property which can be owned by different categories of persons of law (individuals, legal entities and

the State). In addition, the Civil Code generally recognised transferability of digital assets, but specified that specifics of circulation of digital assets shall be regulated by the RK legislation and acts of the AIFC. As one of such specific regulations in RK laws, the prohibition of circulation (i.e., transferability) of unsecured digital assets (i.e., cryptocurrency) has been set out in the Law on Informatisation.

Generally, all the legal terms and basic provisions regarding digital assets are set forth in the Law on Informatisation. Particularly, the new terminology includes the following legal terms and their definitions:

“digital asset” means property created in digital form with appliance of cryptography methods and computing, not being a financial instrument, and a digital form of property rights certification (Article 1 (55-1));

“digital token” means a type of digital asset serving as a digital method of record, exchange and certification of property rights (Article 1 (56-1));

“blockchain” means an information and communication technology ensuring permanence of information in the distributed platform of data on the base of interdependent data blocks chain, established algorithms of integrality validation and cryptography methods (Article 1 (38-2));

“distributed platform of data” means a technological platform, which components are interconnected with the established algorithms, placed on the various nodes of network, may have one or more possessors and may have varying level of identical data (Article 1 (39-1));

“digital mining” means a process of conveying of calculating operations with the usage of computer, power supplies according to established algorithms of encryption and data processing ensuring validation of data blocks integrality in the informatisation objects by methods of blockchain (Article 1 (55-3));

The definitions of “blockchain”, “distributed platform of data” and “digital mining” are purely technical and they do not include any legal content and, in general, we see no practical sense in defining technological terms by legislative acts. However, the definition of “digital assets” has certain legal significance and deserves a legal consideration.

It appears that the RK legislator tried to establish a broader definition of “digital asset” to cover all the diversity of instruments presented in the crypto market. Such an approach seems reasonable because, as of today, existing cryptocurrencies co-exist with other digital assets like non-fungible tokens and tokenized assets (securities, metals, goods and raw materials). Besides, the definition can include potential new instruments emerging from time to time on the rapidly evolving crypto market.

At the same time, the Law on Informatisation classifies digital assets in two major groups: (i) secured and (ii) unsecured (Article 33-1 (2)). As said above, secured digital assets are not related to the cryptocurrencies and specifics of the legal framework are not analyzed herein.

However, we should mention that under the acting law, regardless of their type, digital assets shall not ensure rights on the financial instruments and they shall not provide their owners/possessors with rights in relation to a legal entity (obviously, the law means shareholder or participants rights in a company). We understand that such restriction was introduced as the RK’s response to at least the following two issues.

The first one relates to the well-known “US Securities and Exchange Commission vs. Ripple” case where Ripple is alleged in unregistered securities offering and the court has to decide whether the XRP cryptocurrency is a security or not. In that context, under the RK law Ripple’s XRP could be qualified as an unsecured digital asset.

The second problem which the RK legislator obviously intended to resolve was the exclusion of the situation where tokenized securities could be treated as traditional investment securities such as shares, corporate bonds and, probably, treasury notes.

In April 2022, the NB RK cancelled the above mentioned prohibition regarding banks’ operations with cryptocurrencies which previously existed in the Rules of Risk-Management and Internal Control in Banks. Instead the NB RK introduced the provision which requires banks to reject operations with high-risk of AML/CFT. In addition, those Rules were amended with strict and precise AML/CFT provisions concerning banks’ interaction with the AIFC participating companies in case when such companies

provide services on management of a digital assets' platform, as well as concerning banks' clients operations involving the clients' interaction with the AIFC participating companies [33].

Analyzing such development of the legal framework for digital assets in Kazakhstan, we understand that the NB RK demonstrates a cautious approach by allowing only banks to process corresponding transactions, keeping previous prohibitions for the indexation of nominal value and interest rate of bonds in digital assets, as well as the circulation of financial instruments which price depends on cryptocurrency price as well as for brokers, dealers and managers of investment portfolios.

Finally, in 2022 a draft of the Law on Digital Assets was developed. The purpose of such Law is to codify most of the regulations concerning digital assets, determine characteristics of secured digital assets, introduce licensing regime for mining data-centers' activity, as well as to restrict circulation of unsecured digital assets (including their issuance and mining, crypto exchanges' activity) to allow it only within the jurisdiction of the AIFC (which is not the jurisdiction of the RK).

### *8.2. The Astana International Financial Center (AIFC)*

As mentioned above, the AIFC cannot be considered as existing under jurisdiction of the RK (although, it was created based on the Constitutional law of the RK, it is located in the RK and the part of the RK territory was given to its location). However, despite the legislative prohibition for cryptocurrencies' circulation in the RK, the AIFC regulations allow functioning of cryptocurrencies exchanges within its regulatory framework and its activity can considerably affect business practice in the RK jurisdiction.

However, since 15 November 2020, participants of the AIFC (i.e., companies registered under the AIFC regulations), which perform specified types of activities determined by the Astana Financial Service Authority, have been recognized as subjects of financial monitoring by the RK law.

The financial monitoring under the RK law was established with respect to operations of the AIFC participants involving use of digital assets trading facilities. Such facility functions regularly and brings together multiple parties (whether as principal or agent) with a view to the entering into of contracts: to buy, sell or exchange digital assets for a fiat currency; and/or to exchange one digital asset for another digital asset, in its facility, in accordance with its non-discretionary rules.

The AIFC regulations also chose the term "digital assets" instead of cryptocurrency. The AIFC Glossary defines "digital assets" as a "digital representation of value that can be digitally traded and functions as a medium of exchange; or a unit of account; or a store of value; can be exchanged back-and-forth for fiat currency, but is neither issued nor guaranteed by the government of any jurisdiction, and fulfils the above functions only by agreement within the community of users of the digital asset and accordingly is to be distinguished from fiat currency and e-money" [21].

Obviously, the AIFC Glossary: (I) does not classify digital assets into secured and unsecured types like the RK law does and (II) it considers digital assets as cryptocurrency.

Since 26 October 2021, the AIFC has set forth certain limits on purchasing digital assets by the retail investors. Particularly, AIFC Rules provides that an "authorised digital asset trading facility must maintain effective systems and controls to ensure that a retail client using its service does not invest, in respect of all digital assets in aggregate calculated over a period of one month, an amount which exceeds the greater of: USD 1,000; or the lesser of 10 percent of the annual income; or 5 percent of the net worth of such retail client (excluding the value of the primary residence), up to a maximum aggregate amount of USD 100,000" [2].

According to mass media, the AIFC's participants (who obviously freely deal with the digital assets within the AIFC) "will soon start working with local banks allowing their clients the opportunity to officially and openly work with cryptocurrency" [4]. And in September 2022, one of the RK's major banks completed its first purchase of crypto for fiat [14] involving the AIFC based cryptocurrency exchange. The purchase was performed within the framework of crypto exchange-client-bank [15].

Implementation of the mentioned purchase operation certainly violates the RK law which currently prohibits circulation of cryptocurrencies in Kazakhstan. The circulation of cryptocurrency is not prohibited

within AIFC and such of their intention means an unreasonable attempt to extend the extraterritorial influence on the RK individuals and companies who are prohibited from dealing with cryptocurrencies.

We understand that the RK regulators try to restrict the circulation of cryptocurrencies among the RK's residents only to the investing purposes. But the access to the cryptocurrencies stored on the digital wallets of the AIFC-based crypto exchanges granted to the RK's resident banks will create a high risk of transition of payment operations from national currency (Kazakhstan Tenge) to the cryptocurrencies.

We would like to stress out that even if such operations would be performed within the AIFC's framework, the result of them (for example, transfer of goods, works and services) will take place on the territory of the RK. Thus, the established prohibition of cryptocurrencies' circulation in the RK territory (which is restated in the draft of the Law on Digital Assets) obviously shall be ineffective. We can already observe the announcement of a payment instrument (bank crypto card) to be issued by the end of 2022 which will cause indirect circulation of cryptocurrencies in the RK's territory [14, 39].

### *8.3. The RK Central Bank's Digital Currency Pilot Project*

In December 2021, the National Bank of the RK published the Report on its pilot project concerning development of digital Tenge (the "DT") as a central bank's digital currency (the "CBDC") [27].

The main objectives of the pilot project for 2021 included the test of the feasibility of the DT concept through the experimental confirmation of the technological realization based on distributed ledger technology as well as the definition of the core CBDC model parameters for the RK together with all stakeholders.

Among the achieved advantages of the implemented technological solutions the following was mentioned in the Report:

(I) "tokenization of ownership": the DT is stored by the user in the form of tokens in a digital wallet on the mobile device (or another gadget) which enables full control over money;

(II) "offline payments": DT users can make purchases when both the customer and the merchant do not have Internet access;

(III) "customizable anonymity": transaction details can be hidden from all settlement participants (including at the user's choice) while ensuring a possibility to carry out necessary checks;

(IV) "special purpose tokens": the programmability of the DT allows to put restrictions on spending in token structure and simplify tracking of its use on special purposes;

(V) "simplicity of integration": DT infrastructure provides an opportunity for easy connection and implementation of their scenarios for traditional (second-tier banks) and new (fintech) financial market players.

The Report sets out milestones for the future research for the DT implementation one of which, elaboration of regulatory aspects of the DT introduction, will make it possible to develop a list of specific recommendations for exclusion of legal unambiguity and create a balanced environment for the functioning of the DT. Necessary changes will be identified to consolidate vocabulary, define roles, rights and obligations of participants in DT circulation, establish regulatory mechanisms to control potential risks, cover all relevant AML/CFT aspects, etc.

We share the position that money as a legal tender and national currency cannot be issued by any person except for the State. The CBDC represents a form of fiat money backed by the State and, as in Kazakhstan, secured, at least, by all assets of the NB RK.

## *IX. Conclusion*

The existing legal framework in the RK does not allow circulation of cryptocurrencies but leaves some room for their circulation in exceptional situations. Such exceptions have to be provided for in the law, but at this point no such exceptions exist. It seems that with the success of introduction of the digital national currency by the NB RK (i.e. DT), those rooms for circulation of privately issued cryptocurrencies shall disappear entirely.

As we knew from the Press Release, it is envisaged to introduce a digital mining licensing regime aimed at "involving the mining product in the economy of Kazakhstan" [11]. We also

understand that a general prohibition on the circulation of cryptocurrency in the Republic of Kazakhstan has been maintained.

However, we think that cryptocurrency represents “a mining product” and, in this regard, it is very unclear how, with such a prohibition, it will be possible to “involve cryptocurrency in the economy of Kazakhstan”, even if a digital mining licensing regime and the obligation for all miners to “work through accredited Kazakh mining pools” shall be introduced in the law of Kazakhstan.

While the legislative possibility for circulation of cryptocurrencies exists, the set of NB RK’s rules adopted in 2018 where the circulation and denomination of securities in cryptocurrencies is prohibited should be brought in line with the legal framework established by the Law on Informatisation. It should, among other, include unification of legal terminology related to digital assets.

Controversies of the existing legal framework can be used as a basis for the disputes and litigations where digital miners owning cryptocurrencies can claim an unconstitutionality of existing restrictions of their ownership rights. This risk will exist until a clear prohibition of mining and the existence of ownership rights to cryptocurrency will be established by the law.

In general, we suggest that mining on the territory of Kazakhstan shall be also prohibited by law. Such prohibition seems necessary to avoid the aforementioned risk of litigation where miners could try to claim their rights to mining and use of cryptocurrencies they own or would own. Besides, it is advisable because mining can be seriously harmful for the national economy and wellbeing of our people.

Due to a very significant deviation of generation of electricity from its consumption, when the frequency in the energy system of Central Asia sharply decreased, an overload occurred in it. As a result, the power systems of Uzbekistan and Kyrgyzstan completely shut down. The correct operation of emergency automatics prevented the full power outage of consumers in the southern zone of Kazakhstan. However, a massive power outage occurred in Almaty and several regions of Kazakhstan [39].

Although this is not stated in official sources of information, some experts believe that such a power outage occurred when automatics were triggered due to a failure of backup power stations to be connected, since “miners use power stations that were in reserve, and as a result, the reserve disappeared. Any loss of any generating asset leads to a power outage” [6]. Also unofficial is the information from the Telegram channel, according to which all 69 companies that are officially registered as “miners” in the RK have been disconnected from electricity since Monday, 24 January 2022, the reason for which is called “a tense situation with maintaining the balance of electricity and power” [1].

In this regard, it seems completely unreasonable to make national backup power stations available to miners to make them able to use those reserves for their narrow material interests, thereby creating risks for the well-being of citizens and the continuity of other (and much more significant) economic activities in the country, as well as ignoring world-wide efforts to ensure a cleaner and more favorable ecology and the environment in general. In particular, one should understand the importance of a responsible conduct of authorized bodies and organizations, not only when establishing a legal regime and legislative prohibitions concerning cryptocurrencies, but also when allocating national resources for the implementation of one or another business activity of private entities in general.

As follows from the Press Release, such incidents will be prevented by measures envisaged in the new law passed by the RK Parliament on 29 December 2022 to protect the national energy system from unregulated mining [11]. Such measures shall include: (i) limiting availability of sources of electricity which can be used for mining (allowing the use of renewable energy, own generation and imported electricity only), and (ii) placing significant restrictions on consumption of electricity directly from the general energy system (where such consumption can be available for miners only with a surplus of electricity and through its purchase exclusively at a specialized exchange of the Kazakhstan’s operator of the electricity and capacity).

Besides, the clear state policy should be formulated and implemented either to insist the AIFC’s regulations also clearly prohibit mining and circulation of cryptocurrencies within its jurisdiction or, at least, prevent involvement of the RK citizens and companies in cryptocurrency operations sourced in the AIFC.

It should also be understood that regulation of digital assets in the AIFC and consequences for the retail clients and national economy heavily depend on bona fides of the officers responsible for the

AML/CFT. Therefore, both a legislative policy of the RK and regulatory policy of the AIFC should include effective measures to ensure appropriate implementation of functionalities by respective officers of those two jurisdictions. Moreover, regulators should provide for an effective mechanism protecting the RK's economy from the indirect circulation of the cryptocurrency which is potentially caused by the cooperation of RK banks and AIFC based crypto exchanges.

Tragic events which took place in the RK (especially in Almaty) in the beginning of January of 2022 showed that the payment infrastructure based on internet connectivity can be useless during a public emergency. Therefore, it is a highly positive sign that the RK's DT project considers the possibility of offline circulation of Digital Tenge.

In a mid-term perspective we see no grounds for existence and circulation of any cryptocurrency unless it is issued by the State and its circulation as a legal tender is fully controlled by the State. Once the State introduces a national digital currency (the DT as the RK's CBDC) and/or allows regulated circulation of foreign CDBCs, we see no reason for circulation of privately created and promoted cryptocurrencies.

We understand that steps to introduce the CBDC all over the world is just an initial stage for the greater changes. The future of circulation of civil rights objects is in a transition from traditional contracts to self-executable smart-contracts fully recognized by many different States and powered by the State recognized blockchains (though, in theory, CBDC may not be necessarily based on blockchain).

In these circumstances, introduction of the DT in the RK shall be considered as a positive development for the automation and digitalization of the circulation of different types of various assets (the most of objects of civil rights) in the RK. As soon as the NB RK decides on introduction of the DT as a third form of national currency (in addition to cash and bank account balances), property rights and some of non-property rights which are currently certified in various centralized state ledgers may be tokenized to allow more effective and secured transfers and circulation.

This is where the legal practice will evolve and probably will require local lawyers to learn coding of smart-contracts which will become a day-to-day necessity either smart-contracts will be a standalone form of agreement or an instrument for implementation of traditional written agreement.

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## **QAZAXISTANDA KRİPTOVALYUTALARIN HÜQUQİ REJİMİ VƏ ONLARIN DÖVRİYYƏSİNƏ NƏZARƏTİN MÜMKÜNSÜZLÜYÜ**

**FƏRHAD KARAQUSOV<sup>1</sup>, ALEKSEY BONDAREV<sup>2</sup>**

### **Annotasiya**

*Bu məqalə Qazaxıstanda kriptovalyutalar üçün hüquqi bazanın inkişafını təsvir edir: 2018-ci ildə maliyyə vasitəçilərinə öz əməliyyatlarında bitkoinlərdən və buna bənzər şeylərdən istifadə etməmələri barədə xəbərdarlıq edildiyi ilk addımlarından, 2020-ci ildə tətbiq edilən onlarla işləmə qadağasına və 2023-cü ildə qadağanın götürülməsi və kriptomininqin tənzimlənməsinin*

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<sup>1</sup> Almatı Xəzər Universitetinin Xüsusi Hüquq İnstitutunun aparıcı elmi işçisi / email: fsk2906@gmail.com

<sup>2</sup> Menecer, Qazaxıstanın Almatı şəhərində “K&T Partners” LLP (Həmçinin «Кей энд Ти Партнерс») şirkətində məsləhətçi

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*Açar sözlər: Qazaxıstan Respublikası, kriptovalyuta, İnformatizasiya haqqında Qanun, rəqəmsal aktivlər, AIFC, rəqəmsal mining, qərar, hüquqi baza.*

## **ПРАВОВОЙ РЕЖИМ КРИПТОВАЛЮТ В КАЗАХСТАНЕ И НЕВОЗМОЖНОСТЬ КОНТРОЛЯ ЗА ИХ ОБРАЩЕНИЕМ**

ФАРХАД КАРАГУСОВ<sup>1</sup>, АЛЕКСЕЙ БОНДАРЕВ<sup>2</sup>

### **Резюме**

*В данной статье описано развитие правовой базы криптовалют в Казахстане: от самых первых шагов в 2018 году, когда финансовых посредников только что предупредили от использования биткойнов и им подобных в своих транзакциях, до введенного в 2020 году запрета на их обращение, с отменой запрета и усилением регулирования криптомайнинга в 2023 году. Авторы показывают, что ни наличие, ни отсутствие законодательного ограничения обращения криптовалют не могут помочь государству контролировать соответствующий оборот. Соответственно, нельзя сказать, что существует эффективное решение, которое одновременно поддерживало бы общественный порядок и защищало права собственности отдельных лиц на криптовалюты.*

*Ключевые слова: Республика Казахстан, криптовалюта, Закон об Информатизации, цифровые активы, МФЦА, цифровой майнинг, решение, правовая база.*

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<sup>1</sup> Ведущий научный сотрудник Института Частного Права Каспийского университета в Алматы, Казахстан / email: fsk2906@gmail.com

<sup>2</sup> Менеджер, консультант в ТОО «К&Т Partners» (ТОО «Кей энд Ти Партнерс») в Алматы, Казахстан