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PROBLEMS OF LEGAL REGULATION OF VIRTUAL ASSETS IN UKRAINE**Pravdiuk M.***PhD in Economics,**Associate professor of Accounting and Taxation Department in Economics
Vinnytsia National Agrarian University***Abstract**

The article considers urgent issues of legal regulation of virtual assets in Ukraine. Specifics of using legal terminology related to the circulation of virtual assets are clarified. The main trends in the introduction of legal regulation of cryptocurrencies and other types of virtual assets are considered. The Draft Law of Ukraine "On Virtual Assets" aimed to regulate legal relations caused by the circulation of virtual assets in Ukraine is analyzed.

Keywords: Virtual assets, cryptocurrency, bitcoin, token, blockchain, legal regulation.

Virtual assets are a phenomenon that has become a part of modern economy and an important element of global assets turnover due digital technologies. Markets are formed around virtual assets, transactions and financial investments are made using them. At the beginning of 2020, there have been more than 5,100 types of virtual assets in the world with a total market capitalization exceeding \$ 250 billion. Market capitalization of the most famous cryptocurrency bitcoin that dominates the cryptocurrency market exceeds 63% and amounts to \$ 159 billion as of early 2020 [1, p.13].

The market of virtual assets is quite developed in Ukraine. Our country is one of the three world leaders by the use of cryptocurrencies and it is in top five leaders by non-cash payments. The Ukrainian community of blockchain developers is one of the largest in the world [13]. Virtual assets have become convenient for the use in Ukraine, as our citizens have certain restrictions in more traditional areas, e.g. lack of stock market, limited access to the global capital market, etc. In addition, Ukraine has legal restrictions on international transfers. In recent years, the market of virtual assets has been growing, but most of them are concentrated in the gray area, which creates potential risks for the state as well as business and users. At the same time, virtual assets have many potential benefits. They could make payments easier, faster and cheaper, offer alternative methods for those who do not have access to regular financial products. However, without proper regulation, virtual assets risk to become a tool for illegal financial transactions by criminals and terrorists. In addition, the need for the legal status of virtual assets is caused by the potential threat of illegal income growth as well as the possibility of money laundering or tax evasion.

On the other hand, the uncertainty of the legal status of virtual assets with cryptocurrencies and token assets as their integral part hinders the development of the virtual assets market in Ukraine. As a result, the owners of virtual assets and businesses providing services in this area face a number of challenges. One of the problems is the lack of opportunities to apply mechanisms to protect property rights. In addition, the uncertainty of the legal status of virtual assets hinders the entry into the Ukrainian market of international companies operating in this area, as the risks of these activities are more important to them than possible profits. As a result, the state and local budgets will not receive significant amounts of taxes from transactions with virtual assets. Considering rapid development of the virtual assets market in Ukraine, the need for its legislative regulation is obvious.

It should be noted that the issues of determining the content and legal essence of virtual assets in legal science are almost unstudied. Analysis of modern scientific publications and research of virtual assets reveals that the number of complex works on the analysis of the essence of virtual assets as an element of legal relations is insufficient both in Ukraine and in the world. Some issues of the introduction and development of cryptocurrency have been examined by domestic and foreign scientists and experts including S. Blemus, T. Dmytrenko, L. Douglas, D. Guegan, I. Huseva M. Kucheriavenko, A. Kud, V. Kostiuhenko, D. Nickolay, E. Smychok, A. Sneyrs, K. Pauwers, T. Petrova, R. Price, L. Friedkin and others. Considering the novelty of the phenomenon of virtual assets and the uncertainty of their legal status in domestic science, the study of the problems of legal regulation of virtual assets is actual and necessary.

Modern digital technologies force us to re-evaluate the concept of tangible assets ranking them the same as intangible, i.e. virtual (digital) assets that exist exclusively in the electronic form. Virtual assets are limitless: they exist in the global and interconnected computer systems [7].

A legal doctrine has got no single approach to the content of the concept of "virtual asset". A number of foreign and Ukrainian researchers identify the concepts of "virtual asset" and "virtual currency". However, according to Kud O.O., Kucheriavenko M.P., Smychok E.M., virtual assets are information resources derived from the right to value and circulating in a distributed register in the form of a unique identifier that allows us to talk about a new object of civil law, namely the right to use information derived from the right to value [12, p. 175, 194]. Researchers do not equate the concepts of "virtual asset" and "virtual currency", emphasizing that virtual currency is a digital expression of value that can be used in the digital form and which functionally seeks to act as a means of exchange, unit of accounting and storage of value [12, p. 107]. Therefore, "virtual asset" is a broader concept.

Today, among the regulators of the world's leading countries, including the European Union, there is no single approach to determining the legal status of virtual assets and regulating transactions with them, in particular, cryptocurrencies, the number of which is growing, such as bitcoin, bitcoin cash, ethereum, litecoin and others. Their growing popularity in the world is caused by the lack of a single concept. It varies from identification with the concepts of "goods", "means of payment", "unit of account" to the concepts of "intangible digital asset", "investment asset", "financial asset", "a particular type of securities", etc. They are also

called “virtual asset”, “virtual currency”, “digital currency”. However, today it is clear that these terms cannot be considered absolute synonyms for cryptocurrencies, as they are broader by the scope (cryptocurrencies are a type of decentralized virtual currency, according to FATF Virtual Currencies Report, 2014). It is also wrong to apply a legal regime of currency to cryptocurrencies solely because of the common name, which causes a number of legal conflicts [16].

It should be noted that most financial regulators around the world, including the European Central Bank, are cautious about legislative initiatives and, in parallel with their own research, they closely monitor further development of new technologies and phenomena to develop the most effective approach to virtual asset management. Today, the term “virtual assets” is used to denote a wide range of assets. In addition, different regulators use different terminology.

For example, in its recommendations of 2019, the Financial Action Task Force (FATF), an intergovernmental body that develops global standards in the field of preventing money laundering and terrorism financing, defines virtual assets as digital representation of value, including virtual currency that can be exchanged digitally or transferred, and which can be used for the payment or investment purposes [4].

The European Central Bank (ECB) defines this term very narrowly as “any asset registered in a digital form which is not and does not constitute a financial claim or financial liability of any individual or legal entity and which does not constitute proprietary rights to the business entity” [3].

The International Organization of Securities Commissions (IOSCO), a financial organization that brings together national securities regulators, defines a “virtual asset” as “a type of private asset that relies primarily on cryptography and DLT or similar technology as a part of its perceived or intrinsic value, and may represent an asset such as currency, commodity or security or be derived from a commodity or security” [5].

The Financial Stability Board (FSB), an international organization that coordinates the work of international and national financial authorities at the international level, provides a similar definition and defines the term as “a type of private asset that relies primarily on cryptography and distributed registry or similar technologies as a part of their perceived or inherent value” [2].

As defined by FSB and ESMA, virtual assets as “a kind of private assets that depend primarily on their type”. For example, cryptocurrencies such as bitcoin and litecoin are virtual assets that are designed to act as currency, i.e. to function as a medium of exchange, a store of value and a unit of account. They are intended to be an alternative to legal tender. For example, tokens are virtual assets that offer their owners certain economic and/or management rights and/or utilities/consumption, digital conceptions of interests or rights (access) to certain assets, products or services. In the legal literature and official documentation, cryptocurrencies are also referred to as “payment tokens”, “exchange tokens” or “currency tokens” [2].

Such uncertainty leads to legal conflicts that are both objective and subjective. Objective reasons include the inconsistency of the development of relations that related to virtual assets, imperfect determination of the status of subjects of these relations, etc. Subjective

reasons include the specificity of the legal regulation of these relations, imperfection of the legislation, imperfection of terminology, etc. The situation is complicated by the fact that the rate of using virtual assets is growing rapidly, and therefore it requires the fastest possible legal regulation.

In many European countries (Spain, Portugal, Switzerland, etc.) there are legal bitcoin ATMs, i.e. ATMs where you can exchange bitcoins for fiat money. In the Netherlands, the legal status of cryptocurrencies as electronic money is regulated. In Germany, in 2013, the Federal Office of Financial Control identified cryptocurrencies as “private funds” that could be used as payment and to replace traditional currency in civil law contracts. Thus, the Ministry of Finance has decided to recognize the cryptocurrency bitcoin as the official means of payment. At the same time, for commercial purposes, activities with this cryptocurrency require a special permit (license), such organizations become under the control of the Federal Financial Supervisory Authority [14]. In the UK, the term “cryptocurrency” is defined in the Money Laundering, Terrorist Financing and Money Transfer Regulations 2017 (MLR) as a cryptographically secured digital representation of value or contractual rights that uses Distributed Ledger Technology (DLT) book and can be transmitted, stored or traded electronically” [6].

According to analysts, the most favorable laws for the circulation of cryptocurrencies have been adopted in Switzerland. The Swiss cryptocurrency exchange ECUREX GmbH is currently the world’s first cryptocurrency exchange platform for fiat money, which fully complies with the regulatory requirements of the Swiss Banking Act. In addition, cryptocurrency transactions in this country were exempt from value added tax – in response to the request of Swiss bitcoin companies to the Swiss Federal Tax Administration, transactions with cryptocurrencies have been recognized in this country as a means of payment rather than transactions providing services or goods. The use of cryptocurrencies in Croatia is legal, but they are not recognized as electronic money and are not equated with legal tender, i.e. cryptocurrencies can be accepted by sellers as a method of payment, but sellers are not obliged to accept them [14].

As we can see, in different EU countries the approach to the legal status of virtual assets differs significantly. Thus, some countries have recognized the feasibility of their use and are working to form a legal framework that would consolidate the legal status of virtual assets (as electronic money, as exchange, as a specific currency etc.), while other countries prohibit their use. However, despite the ban on virtual assets in some countries, their circulation in cyberspace continues to grow. The legal ban on the use of cryptocurrency does not affect the processes of its application. This means that the state does not participate in the processes of using such currency.

It should also be noted that in the international practice there is currently no single approach to determining the content of the mentioned tools and mechanisms for their regulation. Today, the main focus in the legal regulation of virtual assets is made on the prevention of the use of virtual assets to legalize (launder) proceeds from crime, financing of terrorism and proliferation of weapons of mass reduction, fraud with virtual

assets; taxation of profits from this activity; regulation of the activities of virtual service providers.

Since virtual assets include intangible assets that have economic value, that are useful or can be used only in cyberspace, the following types of assets can be distinguished in their structure:

1. Virtual currencies (cryptocurrencies). In 2012 the European Central Bank published a report "Virtual Currency Schemes". It emphasizes that in some cases, virtual communities create and distribute their own digital currency for the exchange of goods (services) and units of account. The report defines Virtual Currency as a type of non-government digital money that is typically created and controlled by developers and accepted by members of a particular virtual community. However, in 2015 the European Central Bank's report defined virtual currency more broadly as a digital expression of the value that is not issued by the central bank or financial institution authorized to issue electronic money. The complexity of the legal status of cryptocurrency as a widely used virtual asset in Ukraine is that cryptocurrency is not electronic money, it is not a payment system or a foreign currency.

2. Virtual goods are intangible objects purchased by the users of social networks and online games. Virtual goods can be used only in specific virtual environment, and therefore they have no material value and are not provided with real assets. These include gaming assets, i.e. the assets of virtual game players, namely weapons, equipment, artifacts, game money and other "property" including "appearance" and additional capabilities of the avatar (character) of the player in a multiplayer online game. Such goods include virtual assets in social networks. They also include the user accounts as well as stickers and pictures bought by them as gifts. Such assets are non-convertible, since they are used in limited network domains.

3. Virtual tokens that are entries in the distributed registry.

4. Domain names as identifiers of legal entities or individuals in the Internet [15, p. 200-202].

Foreign researchers A. Sneyrs, K. Pauwers, S. Blemus, D. Guegan identify the following features of virtual assets: they are written on a certain form of digital distributed book protected by cryptography; they are not issued and not guaranteed by the Central Bank or government agency; they can be used as a medium of exchange and/or for investment purposes and/or for access to goods or services [8].

Domestic legislators have made some attempts to define the concept of "virtual asset" and its types, including cryptocurrencies, tokens, etc. Thus, the Draft Concept of the State Policy in the Field of Virtual Assets (which never came into force) proposed the following definitions: "virtual currency is a digital representation of value that is not issued or guaranteed by the Central Bank or government agency, not necessarily related to legislatively approved currency and has no legal status of currency or money, but is accepted by individuals or legal entities as a medium of exchange, which can be transferred, stored and traded electronically", while "virtual assets are any entries in a distributed register records in the form of data, the use of which is expected to lead to economic benefits in the future" [11].

Cryptocurrency as one of virtual assets, but not the only one, is a complex system of information technology procedures that is based on a decentralized mechanism of emission and circulation. The legislation of Ukraine does not define the status of cryptocurrency, at the same time the production and circulation of cryptocurrency in the country is not prohibited.

Recently, the situation with the legal definition of the category of "virtual assets" has changed dramatically, as the concept of virtual assets has been defined by law.

Despite the emergence of the legally defined term "virtual asset", the legal status of such assets and their types still remains improperly regulated by law [10].

According to the Law of Ukraine "On Prevention and Counteraction to Legalization (Laundering) of Proceeds from Crime, Financing of Terrorism and Proliferation of Weapons of Mass Destruction", virtual asset are the digital expression of value that can be traded in digital format or transferred and can be used for payment or investment purposes [10].

The law also stipulates that virtual assets have become the object of financial monitoring, the threshold of financial transactions in the form of virtual assets has risen to UAH 400,000. In particular, control should be exercised over any individual or legal entity (cryptocurrencies, cryptocurrencies, etc.) that provides services to another individual or legal entity on the exchange, transfer, storage and/or administration of virtual assets or instruments that allow to control virtual assets as well as participate in the provision of financial services related to the issuer's offer and/or sale of virtual assets. Such service providers are classified by law as specially designated subjects of financial monitoring and, therefore, they acquire certain responsibilities, and there are high fines if they are unfulfilled [10].

Hence, this law considers virtual assets only from one point of view and within a specific purpose formulated in its preamble and title. According to this definition, there are three criteria for the objects to be considered virtual assets: the value, transferability and payment or investment purpose [20]. Critics have fairly pointed out that a new sphere of legal relations requires a separate special legislative act based on which the amendments to the laws can be made. Otherwise, legal ambiguity and uncertainty in the interpretation of the same concepts in different areas is possible.

Currently, the issue of legal regulation of virtual assets in Ukraine is to be regulated by the Draft Law "On Virtual Assets" No 923-IX of September 29, 2020, which was included in the agenda of the fourth session of the Verkhovna Rada of Ukraine of the ninth convocation. The Draft Law defines the concept and legal status of virtual assets as well as issues of property rights and transactions with such assets in Ukraine [18].

This long-awaited law provides for a comprehensive regulation of relations arising from the creation, release into circulation and circulation of virtual assets, in particular, the conclusion and execution of transactions with them.

The purpose of the Draft Law is also to ensure a comprehensive legislative regulation of the principles of functioning of the market of virtual assets, in particular, to ensure a unified approach to organizing trade of virtual assets.

The legislator defined the concept of virtual assets as a set of data in the electronic form that has value and

exists in the system of circulation of virtual assets. Virtual assets can be both an independent object of civil turnover and certify property or non-property rights, in particular, the right of claim to other objects of civil rights. However, this definition contradicts the definition used in paragraph 13 of Part 1 of Article 1 of the Law of Ukraine "On Prevention and Counteraction to Legalization (Laundering) of Proceeds from Crime, Financing of Terrorism and Proliferation of Weapons of Mass Destruction", according to which virtual assets are treated as a digital expression of value that can be traded in digital format or transferred and which can be used for payment or investment purposes" [10]. Experts draw legislator's attention to the fact that the definition provided by FATF does not deny the civil law circulation of virtual assets, but they are not considered to be a specific type of property [19].

The Draft Law defines the legal status of virtual assets as intangible assets. Virtual assets can be unsecured or secured. Unsecured virtual assets do not certify any property or non-property rights, including claims to other objects of civil rights. Secured virtual assets certify property or non-property rights, in particular the rights of claim to other objects of civil rights. At the same time, it is determined that virtual assets are not a means of payment in Ukraine.

Article 5 regulates the procedure for the creation of virtual assets, introduction of virtual assets into civil circulation and withdrawal of virtual assets from civil circulation.

Ownership of virtual assets is acquired through the creation of virtual assets, conclusion and execution of a transaction related to virtual assets, the law or a court decision, and it is certified by the possession of the virtual asset key.

The conditions of acquisition, transfer and scope of rights to virtual assets can be expressed in the form of algorithms and functions of the system of circulation of virtual assets, within which it has been created. The content of the ownership of virtual assets includes the right to own a virtual asset key and virtual asset itself, the right to use virtual assets and the right to dispose virtual assets on one's own mind if it does not break the law, in particular by transferring ownership of virtual assets. Possession, use and disposal of virtual assets are recorded in the system of circulation of virtual assets (Article 6).

The Draft Law also defines the legal status of participants of the market of virtual assets. Article 9 presents the rights and obligations of participants of the market of virtual assets. Thus, the participants of the market of virtual assets have the right to independently choose a counterparty among the participants of the market of virtual assets; independently choose the prices of virtual assets at which transactions with them are carried out; receive necessary information from service providers related to the circulation of virtual assets; open and use accounts in banking and other financial institutions to carry out transactions with virtual assets; protect their rights to virtual assets legally or in some other way, etc.

Participants of the market of virtual assets are obliged to carry out transactions with virtual assets in good faith and at their own risk; before conducting transactions with virtual assets they should get acquainted with the peculiarities of the functioning of the systems of circulation of virtual assets, in which it is

planned to conduct transactions with virtual assets; strictly adhere to the requirements of the legislation of Ukraine, current international treaties of Ukraine, other regulations governing the circulation of virtual assets; providers of services related to the circulation of virtual assets, at the request of other participants in the market of virtual assets are required to provide necessary, accessible and verified information about themselves, the rules of their work, a full list of conditions, as well as available participants in the market of virtual assets [18].

The Draft Law specifies the types of services related to the operation of virtual assets. They include, in particular, services on the storage or administration of virtual assets or virtual asset keys; virtual asset exchange services; virtual asset transfer services; financial services related to the public offering and/or sale of virtual assets.

Circulation of virtual assets is regulated by the state. The general principles of state regulation of the circulation of virtual assets are as follows: expediency; efficiency; balance; predictability; transparency and consideration of public opinion.

The central executive body that formulates and implements state policy in the field of virtual assets is the Ministry of Digital Transformation of Ukraine, which forms and ensures the implementation of state policy on the development and functioning of the market of virtual assets, promoting adaptation of Ukrainian legislation on virtual assets to the international standards [18].

The Draft Law proposes to regulate the activities of suppliers related to the circulation of virtual assets through mandatory state registration (Article 16). The state registration procedure provides for the applicant (a person who plans to operate as a service provider related to the circulation of virtual assets) to receive a registration decision from the Central Executive Body, which formulates and implements state policy in the field of virtual assets. The Draft Law defines the criteria to be met by the applicant for state registration, the mechanism of the state registration procedure, the grounds for refusal of state registration or cancellation of state registration of service providers related to the circulation of virtual assets.

It also provides for the creation and operation of a state register of providers of services related to the circulation of virtual assets, i.e. an electronic database that contains information needed to perform regulatory and supervisory functions by the Central Executive Body, which formulates and implements state policy in the circulation of virtual assets.

Control over the implementation of legislation in the field of circulation of virtual assets is carried out by the Central Executive Body, which formulates and implements state policy in the field of circulation of virtual assets within its powers and in the manner prescribed by the Constitution and laws of Ukraine. Thus, this body has the right to apply financial sanctions to the individuals that are guilty of violating the law in the field of circulation of virtual assets, e.g. for activities that can be characterized as those providing services related to the circulation of virtual assets without state registration – a fine in the amount of two-five thousand non-taxable minimum incomes; those providing knowingly false or incorrect information by the service pro-

viders when submitting reports of related to the circulation of virtual assets - a fine of one thousand to two thousand non-taxable minimum incomes; for the failure of service providers to submit or submit in full the reports information and/or to submit false/incorrect information to the Central Executive Body, which forms and implements state policy in the field of circulation of virtual assets – a fine of up to one thousand tax-free minimum incomes, etc. [18].

Article 21 clarifies general principles of international cooperation in the field of circulation of virtual assets, including the following: “1. International cooperation in the field of circulation of virtual assets is carried out in accordance with this Law, current international treaties of Ukraine, other regulations. 2. If an international agreement, the binding nature of which has been approved by the Verkhovna Rada of Ukraine, establishes rules other than those provided for by this Law, the rules of the international agreement are to be applied. 3. The central executive body, which forms and implements the state policy in the field of circulation of virtual assets within its competence, takes into account international experience in the field of the market of virtual assets, recommendations of international or intergovernmental organizations, and ensures implementation of relevant international standards, in particular, financial measures to prevent money laundering and terrorist financing (FATF)” [18].

Thus, the main objectives of this document are to regulate legal relations arising due to the circulation of virtual assets in Ukraine, to determine the rights and obligations of participants in the market of virtual assets and the principles of state policy on the circulation of virtual assets.

The law will apply to legal relationships that arise when providing services related to the circulation of virtual assets. The law will establish the legal status and requirements for providers of services related to virtual assets through the procedures of state registration of such activities as storage and/or administration of virtual assets or tools that enable to control virtual assets; exchange virtual assets; transfer virtual assets; provide intermediary services related to the sale or offer of sale of virtual assets.

It should be noted that a number of scholars and experts insist that the Draft Law has some shortcomings, primarily due to the fact that virtual assets are a new tool in both economics and law, and depend on the development of new technologies. Some issues are of special concern, in particular legal and financial-and-economic consequences of the widespread use of virtual assets in Ukraine including the risks to Ukraine’s financial system and compliance with the requirements to counter the use of virtual assets in order to legalize criminal proceeds and finance terrorism.

In our opinion, a significant disadvantage is that the project does not specify the types of virtual assets. “It is proposed to divide all virtual assets only into secured and unsecured ones. It can be assumed that in this way the creators of the project wanted to get rid of potential contradictions with future internationally recognized concepts. However, they have gone too far trying to simplify. After all, there are no definitions of the subjects of the market of virtual assets, and the concept of emission is not disclosed” [9]. The project does not define such concepts as “cryptocurrency”, “blockchain”,

“mining”, “cryptocurrency exchange”, “token asset”, etc.

Experts also point to inconsistencies in Part 3 of Article 4 of the Draft Project regarding the provision of virtual assets. Such provision is “determined by the transaction under which this virtual asset is created, and the right to claim the relevant object of civil rights is transferred to the purchaser of the virtual asset”. However, a transaction that ensures the discharge of the obligation and a transaction fulfilled are generally considered to be different transactions. In addition, it remains unclear whether all legally defined types of securing the discharge of obligation can act as collateral for virtual assets.

We consider that in the Draft Law insufficient attention is paid to the protection of rights of the owners of virtual assets, which may adversely affect the use of virtual assets, in particular, liability of the provider of services on the storage of virtual assets for the damage to the property owner. In addition, no mechanism has been developed to counter possible financial speculation using virtual assets.

According to experts, the Draft Law was developed without participation of the crypto community that is active in Ukraine, which directly has practical knowledge of blockchain architecture and cryptocurrency technology. Effective practice of Western countries is their active participation in the development of draft laws of business representatives and public organizations of the industry. In the last five years, Ukraine has formed a strong community of professionals and businesses operating in the field of cryptocurrencies, including mining, cryptocurrency exchanges, startups, venture funds, IT companies that develop software based on blockchain technology, which have already received global recognition, as well as the corporate sector that invests in research and development of technologies, including the audit companies of the Big Four and the Ukrainian offices of such IT giants as Microsoft, IBM and others. It is the lack of experts involved in this area that has led to the gaps and confusion in the formulation of terms and categories in draft laws [17].

Considering the process of adaptation of Ukrainian legislation with the European legislation and harmonization with it, it is important for Ukraine to take into account the experience and legislation of the EU when forming state policy in this area. To develop an effective system of state regulation of virtual assets and their legal support, the legislator has to take into account professional international and domestic research and development in the field of digital technologies. In addition, Ukraine needs to coordinate its actions concerning implementation of the legal regulation of virtual assets with relevant international institutions, primarily in order to improve the system for prevention of money laundering and terrorist financing in cyberspace and to comply with cybersecurity standards. It is also important to adhere to the general view on the qualification of virtual assets as financial instruments and to harmonize the legislation of Ukraine in the field of virtual currencies with the EU legislation.

At the present stage it is important for Ukraine to adopt the basic law that will regulate the market of virtual assets. After all, this will increase the state budget revenues, increase foreign currency flows to Ukraine, ensure consumer protection in the field of virtual assets

and virtual currencies, stimulate the development of the digital economy, e-commerce, and innovation activity.

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