



UNIVERSITY *of* **NICOSIA**

MSc in Digital Currency

Introduction to Digital Currencies

DFIN-511

Introduction to Digital Currencies

Session 10: Regulatory and Tax Treatment



UNIVERSITY *of*
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Session Objectives

- ▼ Understand the likely areas of regulation that might impact Bitcoin and other decentralized currencies
- ▼ Develop an initial framework for evaluating different policy choices by nation-states in these areas
- ▼ Develop an appreciation for likely regulatory areas of concern when starting or working at a Blockchain-based business

Agenda Session 10

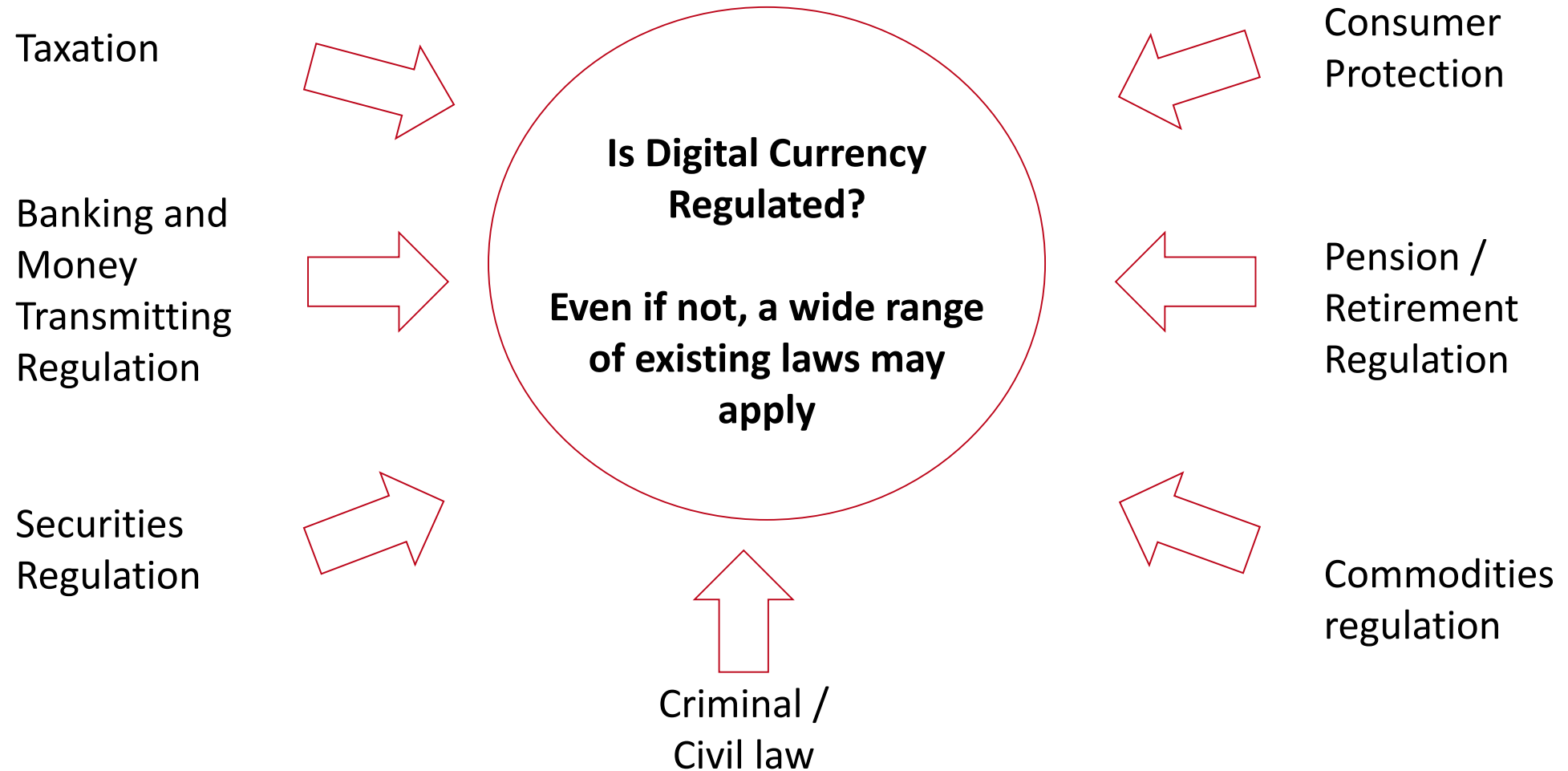
- ▼ Overview
- ▼ Definition and Tax Regulations
- ▼ Money Service Business / Money Transmitter Regulations
- ▼ The NY state “Bitlicense”
- ▼ Securities Regulation
- ▼ ERISA/IRA Regulation
- ▼ Special Topics
- ▼ Conclusions
- ▼ Self-Assessment Exercises and Further Reading



Overview



A heavily regulated arena



Two Key Conundrums

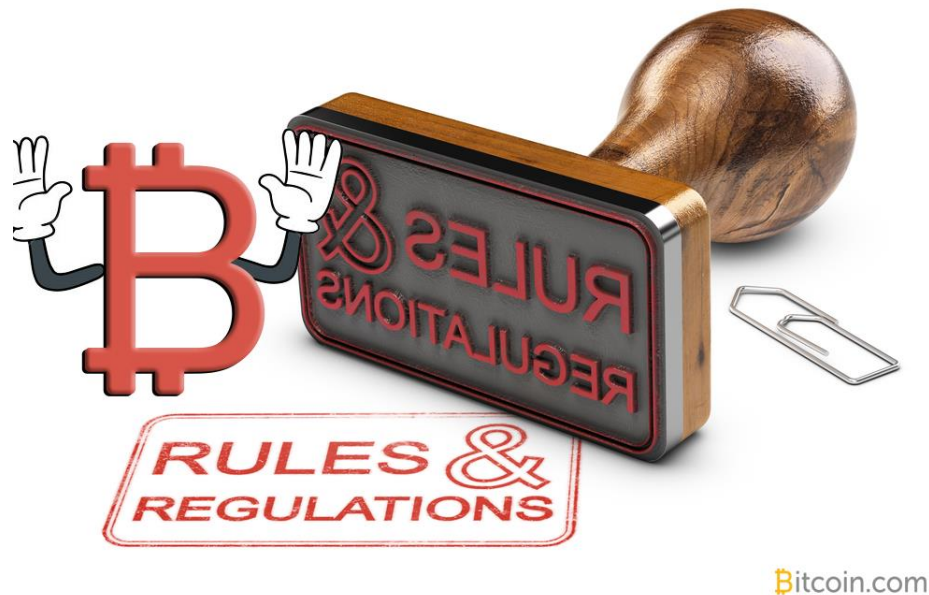
▼ Not Legal Tender

- ▼ Many nation-states have regulations that explicitly define currency as legal tender of another nation-state, preventing them from recognizing other “currencies” formally as currency.
- ▼ This policy does serve a purpose. Bitcoin might behave as a currency, but should a country extend the same treatment to every alt-coin? If so, should this same treatment apply to other forms of digital currencies, such as in-game credits and frequent flier miles?
- ▼ The exceptions to this approach are countries like Germany that allow for the concept of a “unit of account” that can be treated as a form of “private money” used in “multilateral clearing circles”

▼ Property that acts like a currency

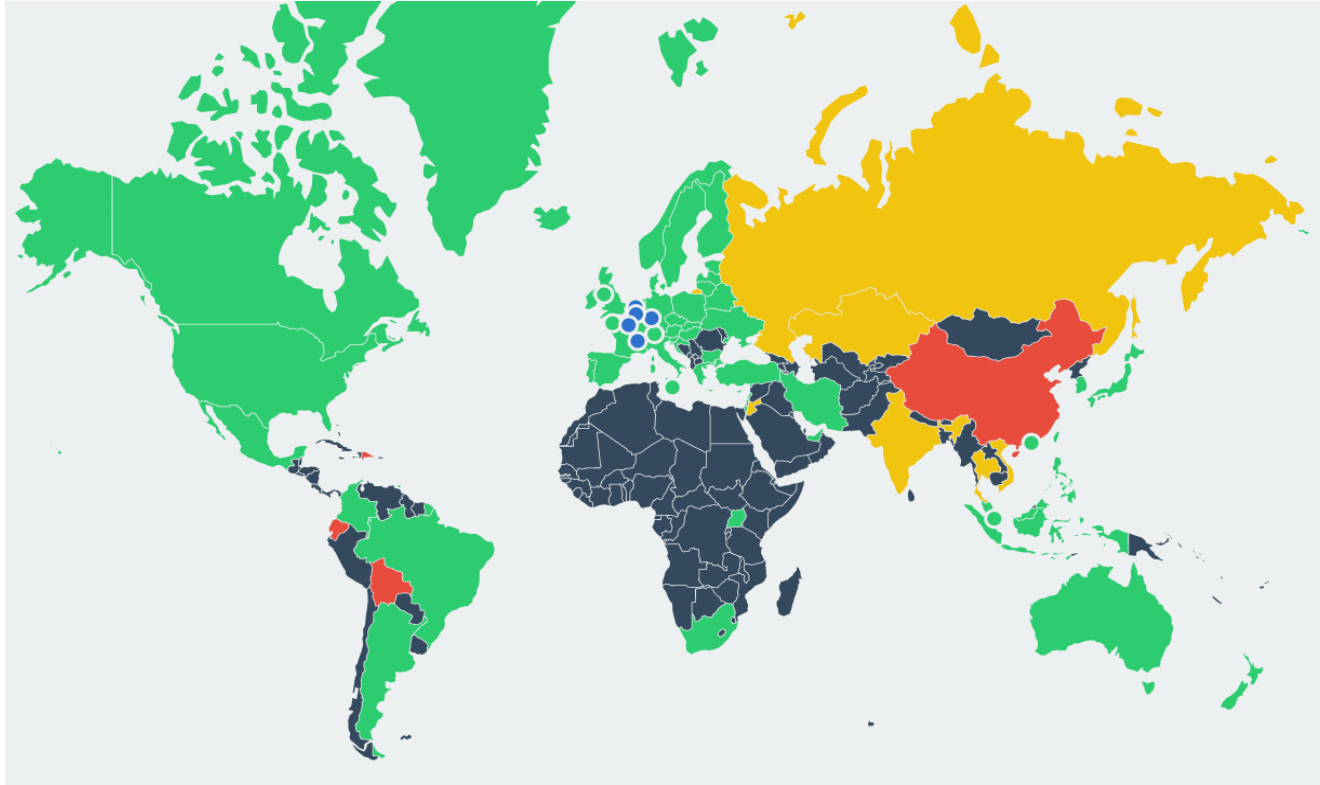
- ▼ If it is not a currency for legal purposes, then digital currency almost certainly is property / asset instead. This seems very logical and consistent from an investor perspective.
- ▼ Most property, however, does not transact as often and in such small amounts as digital currency does, making this potentially burdensome from a consumer perspective.

Regulatory Concerns



- ▼ Market competition and efficiency (no collusion)
- ▼ Consumer protection – fraud and theft;
- ▼ Consumer protection – loss of value (investor protection);
- ▼ Insider trading;
- ▼ Capital controls (China particularly concerned);
- ▼ Tax evasion;
- ▼ Currency controls;
- ▼ Crime Prevention ('Silk Road' ventures, ransom, kidnapping, extortion and data ransom);
- ▼ Anti-money laundering/counter terrorism financing

Current regulatory environment



- Developed, open economies are generally **permissive**. The USA has issued the most guidance and is highly represented in this presentation
- Capital-controlled economies are **contentious** or **hostile** (as they have to be)
- Many African countries (with the exception of South Africa) and a few other countries have not yet addressed the topic and their status is **unknown**

Source: MerkleTree.io (contains some of the latest updates on the specific situation in several US states and countries)



Definition and Tax Regulations

USA

- ▼ The U.S. Treasury classified bitcoin as a convertible decentralized virtual currency in 2013. The Commodity Futures Trading Commission, CFTC, classified bitcoin as a commodity in September 2015. Per IRS, bitcoin is taxed as a property
- ▼ In September 2016, a federal judge ruled that "Bitcoins are funds within the plain meaning of that term"
- ▼ Similar regulations expected in Canada and Mexico
- ▼ Legality of Bitcoin by U.S. jurisdiction: https://en.wikipedia.org/wiki/Legality_of_Bitcoin_by_U.S._jurisdiction
- ▼ **BitLicense:** A business license issued by the New York State Department of Financial Services applicable to those conducting business in the state of New York. The application cost is approximately \$100,000
 - ▼ Required, if business activity involves:
 - ▼ Receiving virtual currency (VC) for Transmission or Transmitting VC, unless for non-financial purposes and only a nominal amount of VC;
 - ▼ Storing, holding, or maintaining custody or control of VC on behalf of others;
 - ▼ Buying and selling VC a customer business;
 - ▼ Performing Exchange Services as a customer business;
 - ▼ Controlling, administering, or issuing a VC
- ▼ Circle, Ripple and Coinbase are the only organizations which received the BitLicense as of September 2017 (more on this later in this session)

Taxation: USA

- ▼ According to IRS - “virtual currency”, for tax purposes, is considered **property**
- ▼ Virtual currency is subject to long-term and short-term capital **gains / losses** upon realization / sale.
- ▼ Income and expenses in digital currencies are **taxed and reportable** as per regular standards.
- ▼ Currency earned through mining is treated as ordinary **income**.
- ▼ This guidance is the most favorable outcome that **investors** in digital currency could have asked for, though it has presented some difficulties for **consumers** using digital currency.
- ▼ **Sales tax was not addressed** by the IRS ruling, as the IRS is the federal tax agency and sales tax is regulated by the individual states.
- ▼ IRS’ recent collaboration with Chainalysis to identify tax evaders:
<https://www.cryptocoinsnews.com/irs-tracked-bitcoin-tax-evaders-since-2015/>

Taxation: USA

- ▼ The most controversial outcome of the IRS decision is the implication that every time you purchase something with, say, a bitcoin you have “sold” bitcoin and therefore have to calculate a capital gain or loss relative to your “basis” (purchase price) of the bitcoins you sold. There is no minimum exemption
- ▼ This treatment would be unworkable in a traditional currency as the record-keeping requirements would be overwhelming. Given that Bitcoin transacts solely electronically, software can calculate all these gains or losses automatically, though there is still a sense that this will be a hindrance to consumers
- ▼ Treating Bitcoin as currency would not, in and of itself, eliminate this issue – corporations have to report foreign currency gains / losses as do individuals

Taxation: USA and what is different in EU

- ▼ This is a good example of where the dual nature of digital currency does not match up well with existing laws. It will be interesting to see if there is political will to make some exemptions for digital currency to encourage its adoption as was previously done with e-commerce (e-commerce was exempted from local and state sales tax given the perceived practical difficulties at the time of correctly calculating these taxes in the early days of the internet)
- ▼ On the personal side, the prospect of citizens transacting on an ongoing basis in a “foreign” currency (say Bitcoin) presents taxation challenges that are different than the normal de minimus use of foreign currency on vacation
- ▼ In EU on the other hand, in October 22, 2015, a court ruling for ECJ judged that bitcoin transactions "are exempt from VAT under the provision concerning transactions relating to currency, bank notes and coins used as legal tender." This change was met with enthusiasm from European exchanges that dwelled in uncertainty on their VAT obligations thus far, and openly enables increased adoption as a payment method.

European Union

- ▼ **2014:** The European Central Bank classifies bitcoin as a convertible decentralized virtual currency. In July 2014 the European Banking Authority advised European banks not to deal in virtual currencies such as bitcoin until a regulatory regime was in place
- ▼ **2015:** The European Union has passed no specific legislation relative to the status of the bitcoin as a currency, but has stated in October 2015 that **VAT/GST is not applicable to the conversion between traditional fiat currency and bitcoin.** VAT/GST and other taxes (such as income tax) still apply to transactions made using bitcoins for goods and services
- ▼ **2016:** The European Parliament's passed a proposal to set up a taskforce to monitor virtual currencies to combat money laundering and terrorism. It has been sent to the European Commission for consideration
- ▼ **2017:** A proposal requiring cryptocurrency exchanges and cryptocurrency wallets to identify suspicious activity was presented by the European commission



Europe

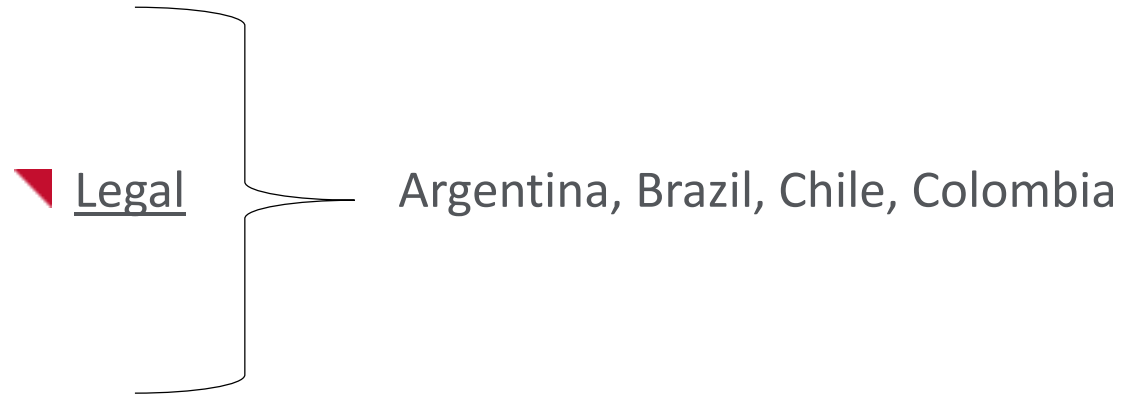
▼ Not regulated, but legal

Cyprus, Croatia, Czech Republic, Poland, Romania, Slovakia, Denmark, Estonia
Russia, Bulgaria, Greece, Italy, Malta, Portugal, Turkey, Belgium, Ireland, Netherlands

▼ Regulated and legal:

- ▼ Germany: “Unit of account” and can be used for tax and trading
- ▼ UK: Treated as private money, no VAT for exchanging BTC to fiat. VAT applicable for goods/services sold for BTC or any other cryptocurrency. Relevant profits/losses subject to capital gains tax
- ▼ Slovenia: Mining and businesses selling goods/services in bitcoin are taxed
- ▼ Switzerland: Bitcoin businesses subject to anti-money laundering regulations and may need a banking license
- ▼ Norway: Bitcoin is an asset and falls under the sales tax regulation
- ▼ Sweden: Subject to Financial Supervisory Authority regulations and treated as currency
- ▼ France: Regulations issued for exchanges, taxation and businesses

South America



Illegal:

- Bolivia: The Central Bank of Bolivia issued a resolution banning bitcoin activities in 2014. 60 cryptocurrency promoters were arrested in May 2017.
- Ecuador: The government banned bitcoin and other cryptocurrency activities in 2014, however use of Bitcoin still grows until now.

Asia

▼ Legal

Saudi Arabia, Lebanon and Jordan have issued warnings on the use of Bitcoins but it is still legal. India has no plans to regulate cryptocurrencies. China allows individuals to hold and trade cryptocurrencies but prohibits financial institutions from doing the same. Japan recognizes cryptocurrencies as a method of payment

▼ Illegal: Kyrgyzstan, Bangladesh

Taxation: UK

- ▼ Treat as any other **foreign currency**
- ▼ **Not VAT-able**, a reversal of its prior decision that it was a VAT-able voucher
- ▼ In early November 2014, a Call for Information was issued to gauge the opinions of participants in the economy on regulation and taxation
- ▼ In a more recent announcement, the FCA announced the creation of a regulatory sandbox for Bitcoin and Ethereum companies in an attempt to bring them close to digital currency businesses.
- ▼ In March 2015, the UK Treasury published its plans to regulate Bitcoin, also noting the potential advantages of digital currencies as a payments technology. Among their plans are to:
 - ▼ Apply Anti-Money Laundering (AML) regulation to digital currency exchanges in the UK for the purpose of supporting innovation and for prevention of criminal use.
 - ▼ Work with the British Standards Institution (BSI) and the digital currency industry to develop standards for consumer protection.
 - ▼ Increase digital currency research funding by £10M and bring together various research councils, the Alan Turing Institute and Digital Catapult with industry, in order to research digital currency technology opportunities and challenges

Taxation: Other Notable Approaches

▼ France

- ▼ The French Ministry of Economy and Finance announced in July 2014 that measures and taxes were to be placed until the end of the year, although not recognizing digital currencies as official currencies.
- ▼ A threshold is to be placed at €5,000, so that people can “*try, invest and develop business with Bitcoin*”, before it becomes subject to taxes.
- ▼ Robert Ophele, president of the Autorite des marches financiers (AMF), the domestic financial markets regulator, said that soon his agency is planning to finalize regulations on ICOs

▼ Japan

- ▼ JADA (Japan Authority of Digital Asset) was formulated to create and establish standards, best practices and guidelines and offer advice and consultancy, for the safe and sound operation of its members.
- ▼ In 2014, the Japanese government made a decision that did not recognize bitcoin as currency nor bond under the current Banking Act and Financial Instruments and Exchange Law, prohibiting banks and securities companies from dealing in bitcoins.
- ▼ In 2017, the country’s government officially recognized bitcoin as a method of payment.

Taxation: Other Notable Approaches

▼ Brazil

- ▼ Treat as a **financial asset** subject to 15% capital gains tax (reference)
- ▼ As such, bitcoins must be filed as an income tax return on how much they are worth and how much profit was made
- ▼ Receita Federal (the Federal Revenue service) decided that bitcoins must be declared as “other goods” when their value is higher than BRL 1,000
- ▼ When more than BRL 35,000 worth in bitcoins is earned as profit, it is subject to income tax
- ▼ Central bank’s president Ilan Goldfajn, recently compared Bitcoin to a pyramid scheme, even though legislators in Brazil seem to work out a regulatory framework for domestic cryptocurrency activities.

▼ Australia

- ▼ In August 2014, ATO defined that Bitcoin and all digital currencies are subject to existing Goods and Services Tax (GST) for sales and Capital Gains Tax (CGT), similarly to equities and other assets (for sums over \$10,000);
- ▼ In April 2015, the Reserve Bank of Australia (RBA) indicated that it is not in favor of regulating Bitcoin or other digital currencies, since “*any benefits of regulation would outweigh the costs*”. They also stated that, “*...digital currencies don’t raise concerns with regards to competition, efficiency or risk to the financial system*”.
- ▼ However, now it seems that regulations are close to being imposed. The use, trading and mining of Bitcoins is legal and the Australian Taxation office has announced its intention to establish guidelines on VAT and capital gains tax

Taxation: Other Notable Approaches

▼ Denmark

- ▼ Denmark's Financial Supervisory Authority (Finanstilsynet) rejects bitcoin as a currency and stated that it will not regulate bitcoins
- ▼ Personal gains and losses from trading digital currency are **not taxable** (or tax-deductible)
- ▼ Corporations whose primary business is digital currency trading are taxable
- ▼ The FSA has now suggested amending the present legislation so that virtual currencies and regulation come under their remit.

▼ Finland

- ▼ The Finish Tax Authority has issued instructions for the taxation of Bitcoin and other digital currencies
- ▼ When transferred to another currency, the rules on taxation of capital gains apply
- ▼ When the currency is used as a form of payment for goods and services, it is treated as a trade, and the increase in value that the currency might have gained after it was obtained is taxable
- ▼ Losses are not-tax deductible
- ▼ A bitcoin transaction is considered a private contract equivalent to a contract for difference for tax purposes

Taxation: Other Notable Approaches

▼ Russia

- ▼ Issued warnings in January 2014 that the use of currencies besides the ruble is illegal, and has since proceeded to release draft bills with the penalties involved for the promotion and use of “money surrogates” like Bitcoin.
- ▼ The Russian Central Bank views the services of Russian legal entities aimed at assisting in the exchange of bitcoins for goods, services, or currencies as a "dubious activity" associated with money laundering and terrorism financing
- ▼ One update from Russian Central Bank's governor : “...*this is something definitely the market will be welcoming so we will be watching with attention and, if necessary, regulate it.*”
- ▼ **Following a meeting with Vladimir Putin, Russian regulators announced that cryptocurrencies will officially be regulated in Russia. A framework is expected to be established by the end of 2017 as a joint effort of the central bank and the finance ministry.**

China

- Prohibition on Bitcoin activities by any financial institutions caused Bitcoin trading to sink
- On 11 January 2017 the central bank announced investigations into Bitcoin exchanges in Beijing and Shanghai. Looking at unlawful activities, such as money laundering, margin trading, and transferring funds abroad. Prices fell 10%.
- On January 22, China's three largest exchanges ended free Bitcoin trading to curb speculation. Bitcoin trading dropped further due to fees imposed. On February 9, the PBoC met with nine Bitcoin exchanges to remind them of potential risks. The two largest exchanges, OkCoin and Huobi.com, temporarily halted withdrawals from their platforms. BTCChina also announced a 72-hour waiting period for withdrawals.
- China's recent ICO ban affected many startups which now look overseas to list their tokens

| Home Bitcoin Markets Charts About | | | | | | Apr 14, 2017 07:06:11 (UTC) | | | | | |
|-----------------------------------|---------------|--------------|---------|----------------|-----------------------|-----------------------------|------------|----------|---------------|----------------------|----------|
| Symbol | | Latest Price | 30 days | Average | Volume | Low/High | Bid | Ask | 24h Avg. | Volume | Low/High |
| ▲ | coincheck | 132365 | | 121662.81 | 572,515.94 | 98592 | | | | | |
| JPY | coincheckJPY | 0 min ago | | 10702.19 8.80% | 69,653,895,383.56 JPY | 145743 | 132365 | 132414 | 130784.42 | 17,160.81 | 126666 |
| | | | | | | | | | 1580.58 1.21% | 2,244,367,250.22 JPY | 133861 |
| ▲ | Kraken | 1119.12 | | 998.76 | 410,258.26 | 815.824 | | | | | |
| EUR | krakenEUR | just now | | 120.36 12.05% | 409,751,532.80 EUR | 1179.498 | 1118.693 | 1119.887 | 1104.76 | 12,836.45 | 1080.2 |
| | | | | | | | | | 14.36 1.30% | 14,181,248.22 EUR | 1132.634 |
| ▲ | BitStamp | 1188.5 | | 1074.57 | 272,463.48 | 891.33 | | | | | |
| USD | bitstampUSD | 0 min ago | | 113.93 10.60% | 292,779,928.78 USD | 1260 | 1188.49 | 1189 | 1175.76 | 7,194.70 | 1141 |
| | | | | | | | | | 12.74 1.08% | 8,459,229.34 USD | 1209.65 |
| ▼ | OKCoin | 7101.99 | | 7038.04 | 217,248.83 | 6151 | | | | | |
| CNY | okcoinCNY | 0 min ago | | 63.95 0.91% | 1,529,005,043.63 CNY | 8010 | 7060.52 | 7088.73 | 7109.38 | 4,724.91 | 7006 |
| | | | | | | | | | -7.38 -0.10% | 33,591,141.20 CNY | 7212.74 |
| ▼ | BTC China | 7100 | | 7039.72 | 191,305.72 | 6119.43 | | | | | |
| CNY | btccCNY | 0 min ago | | 60.28 0.86% | 1,346,737,756.92 CNY | 8080 | 7120 | 7120.2 | 7126.69 | 3,000.64 | 7068 |
| | | | | | | | | | -26.69 -0.38% | 21,384,663.65 CNY | 7219.99 |
| ▲ | Kraken | 1192.003 | | 1079.58 | 104,748.75 | 881.891 | | | | | |
| USD | krakenUSD | 1 min ago | | 112.42 10.41% | 113,094,655.45 USD | 1259 | 1192.003 | 1196.598 | 1180.07 | 2,820.08 | 1151 |
| | | | | | | | | | 11.94 1.01% | 3,327,883.24 USD | 1211.155 |
| ▲ | itBit | 1193.9 | | 1088.35 | 91,224.14 | 890.37 | | | | | |
| USD | itbitUSD | 0 min ago | | 105.55 9.70% | 90,284,132.88 USD | 1260 | 1193.9 | 1194 | 1180.68 | 2,966.65 | 1152.15 |
| | | | | | | | | | 13.22 1.12% | 3,562,857.49 USD | 1212.35 |
| ▲ | BitBay | 4705.08 | | 4417.99 | 38,794.75 | 3560 | | | | | |
| PLN | bitbayPLN | just now | | 287.09 6.50% | 171,394,997.88 PLN | 5149.99 | 4705.06 | 4716.97 | 4702.46 | 1,802.80 | 4573.01 |
| | | | | | | | | | 2.62 0.06% | 8,477,817.45 PLN | 4840 |
| ▲ | LocalBitcoins | 1589.63 | | 1244.04 | 28,730.75 | 157.99 | | | | | |
| USD | localbitUSD | 1 min ago | | 345.59 27.78% | 35,742,277.10 USD | 51475.63 | 1299920.92 | 830 | 1331.72 | 841.55 | 952.4 |
| | | | | | | | | | 257.91 19.37% | 1,120,711.45 USD | 14140.8 |
| ▲ | bitcoin.de | 1164 | | 1006.53 | 23,234.47 | 663 | | | | | |
| EUR | btodeEUR | 3 min ago | | 157.47 15.65% | 23,386,123.90 EUR | 1800 | 1112.65 | 1120 | 1114.59 | 738.62 | 1046 |
| | | | | | | | | | 49.41 4.43% | 823,284.70 EUR | 1250 |

A decorative pattern of various-sized triangles, some solid and some outlined, in shades of red and pink, arranged in a complex, overlapping geometric design along the left and bottom edges of the slide.

Money Service Business / Money Transmitter Regulations

Banking and Money Transmitting: USA

- ▼ FINCEN (Financial Crimes Enforcement Network) is the bureau of the US Department of Treasury tasked with fighting financial crime. It has made two public rulings regarding “virtual currency” clarifying which parties in the digital currency ecosystem are **MSBs (Money Service Businesses)** and are therefore subject to regulation:
- ▼ **Consumers** are **NOT** MSBs: *“A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is **not** an MSB under FinCEN's regulations”*
- ▼ **Miners** are **NOT** MSBs so long as they are mining for their own account. If they are mining in order to transmit money for others to third parties, they would be MSBs
- ▼ **Exchanges** **ARE** MSBs if they allow transmission of value to third parties. In the Bitcoin ecosystem, that would mean that firms like Coinbase would be MSBs as would full exchanges.

What does it mean to be an MSB?: USA

- ▼ Who are MSBs? (1) Currency dealers/exchangers, (2) Check cashers, (3) Issuers of traveler's checks / money orders or stored value cards, (4) Sellers/redeemers of traveler's checks, money orders or stored value cards, (5) Money transmitters, and (6) The US Postal Service.

Once a firm is classified as an **MSB**, it triggers a wide range of regulatory requirements in the United States such as:

- ▼ Having to **register** with the Department of the Treasury
- ▼ Developing a **customer identification** (Know Your Customer) and **AML** (Anti-Money Laundering) program with policies, procedures, internal controls, compliance officers and independent review
- ▼ **Reporting** cash or suspicious transactions under the Bank Secrecy Act
- ▼ **State-level registrations:** Almost all states require registration or licensing for MSBs that operate in their state, and in some cases, that transact with citizens of their state, even if they don't have operations in-state. New York State, in particular, is in the process of developing special regulations for digital currency exchanges that might serve as a model for other states.

The accidental MSB?: USA

- ▼ Legal penalties for violating MSB regulations (even unknowingly) are very severe and can include heavy fines and jail time.
- ▼ Prior centralized digital currency firms such as e-Gold and Liberty Reserve were indicted and closed for failing to register as money transmitters (among other charges). Several early Bitcoin firms such as Mt.Gox (May 2013) and BitInstant (Jan 2014) also ran afoul of MSB regulations. It has been interesting to see that with decentralized currencies, the regulatory problems of individual businesses have gained all of the attention of regulators, without attracting any towards the currency itself
- ▼ **MSB compliance is expensive and time-consuming.** This means that startups using digital currencies in MSB contexts will need to be well-funded and have strong compliance expertise
- ▼ FinCEN recently fined BTC-e for facilitating transactions involving Ransomware, computer hacking, identity theft, tax refund fraud schemes, public corruption, and drug trafficking.

The accidental MSB?: USA

- ▼ MSB regulations can ensnare individuals who might have never considered themselves to be in the MSB business, including repeated sellers/buyers of bitcoins on an individual basis (through localbitcoins.com) or sites that trade bitcoins for other stored value products (such as pre-paid cards or stored value cards).
- ▼ A guidance released by FINCEN on October 27 2014 further complicates things regarding MSB registration and whether Bitcoin companies fit within. This guidance is mostly related with custodial bitcoin exchanges and payment processors, and the fact that they may be considered MSBs under US law.

<https://www.cryptocoinsnews.com/fincen-clarifies-virtual-currency-payment-systems-trading-platforms-money-transmitters/>

- ▼ A more unusual approach has been taken by [ITBit](#) in New York State where it has registered as a (heavily regulated) trust company in order to offer exchange services. This is a unique approach to date, as they offer full fiat & bitcoin asset protection, and customer security and protection.

A decorative border on the left side of the slide, composed of various triangles in different shades of red and pink, arranged in a complex, overlapping geometric pattern.

The NY state “Bitlicense”

A decorative border on the right side of the slide, featuring a few triangles in dark red and pink, including a solid dark red triangle at the top.

The state of NY “Bitlicense”

- ▼ On July 23th, 2014, the Department of Financial Services of the New York state published an analytical report on the new codes, rules and regulations that users of Virtual Currencies, or organizations providing “Virtual Currency Business Activity” should comply with, finalizing it in June 3, 2015.
- ▼ In their announcement, the state of New York, defined as “virtual currency” the **digital means** that are used as a medium of exchange or store of value, or as a part of a payment system.
- ▼ These means of digital currency fall under 3 categories: “(i) *have a centralized repository or administrator; (ii) are decentralized and have no centralized repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort.*”
- ▼ The announcement clearly excludes any form of private money used, for instance within online games or in a customer loyalty program.

Source: <http://www.dfs.ny.gov/legal/regulations/adoptions/dfsp200t.pdf>

Bitlicense - definitions

- ▼ According to the same announcement, businesses that are involved with processes like the following, are considered to perform a “*Virtual Currency Business Activity*” and should receive a written license before they establish their operation.
- ▼ Parts of the proposal include collecting personal data of the consumers, including full names and addresses, and maintain these records for 10 years. Moreover this not only includes conventional providers of financial services, but also other companies like wallet provider Blockchain.info that have no access to their customer’s funds.
- ▼ The processes requiring a license are, summarily, the following:
 - “- receiving Virtual Currency for transmission or transmitting the same;*
 - securing, storing, holding, or maintaining custody or control of Virtual Currency on behalf of others;*
 - buying and selling Virtual Currency as a customer business;*
 - performing retail conversion services, including the conversion or exchange of Fiat Currency or other value into Virtual Currency, the conversion or exchange of Virtual Currency into Fiat Currency or other value, or the conversion or exchange of one form of Virtual Currency into another form of Virtual Currency; or*
 - controlling, administering, or issuing a Virtual Currency.”*

Source: <http://www.dfs.ny.gov/legal/regulations/adoptions/dfsp200t.pdf>

How to obtain a Bitlicense

- ▼ To receive such a license, the interested organization has to submit a formal application accompanied with different complementary archives, such as description of the business about to be established, its organizational structure, financial statements and a background report from an independent agency.
- ▼ A certain fee should be paid for the superintendent's services; the superintendent is responsible to positively or negatively respond to each application within 90 days of its submission.
- ▼ The company/business should employ a compliance officer and set up specific guidelines and internal processes, in order to ensure it will comply with the New York state laws.
- ▼ A certain capital requirement should be met at any point in time, so as to ensure customer protection. The company should also keep a certain amount of bonds in US dollars for the same reason.
- ▼ A written permission should be received by the superintendent before any changes are performed in the organization, the business processed, the offering (product or service) to the end customer, or before a merger or acquisition takes place.

Source: <http://www.dfs.ny.gov/legal/regulations/adoptions/dfsp200t.pdf>

How to obtain a Bitlicense

- ▼ Moreover, the superintendent must be able to check and examine the company's books and records, and also ask for reports and financial disclosures, reviewing the company's financial soundness, management policies and compliance.
- ▼ An Anti-Money-Laundering (AML) program must be established to provide the company with internal control, processes to test compliance at any point in time, as well as training mechanisms for every new employee entering the company.
- ▼ Last but not least, the company should also maintain, as part of the AML program, a customer identification program that will enable identification and verification of account holders, the same for large transactions as well as enhanced due diligence for foreign account holders.

The initial proposed BitLicense, has so far, caused significant correspondence from the Bitcoin Foundation and nearly every major Bitcoin service provider operating in the USA including Coinbase, Bitpay, Circle, Xapo and several others including the EFF. The superintendent has hence reconsidered some of the statements included in the original draft, but without sweeping differences from the original proposal.

BitLicense FAQ's: http://www.dfs.ny.gov/legal/regulations/bitlicense_reg_framework_faq.htm

Bitlicense and industry response so far

- On September 2015, Circle became the first Bitcoin business to be granted a Bitlicense in New York. The NYFDS confirmed in August 2015 that it had received 22 applications while others have completely ceased operations in NY. Since Coinbase was awarded the third BitLicense in January 2017, no further developments were known and the future does not look promising for this concept.

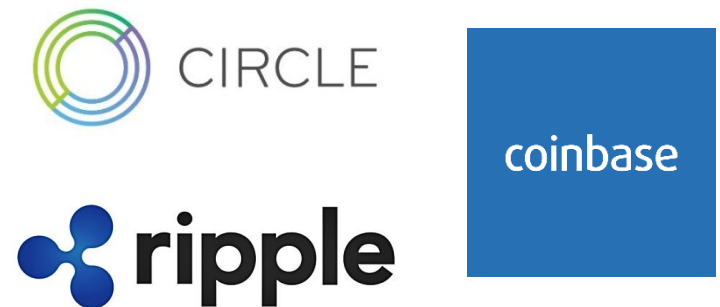
Examples of Companies Applying

| |
|------------|
| BTCC |
| Xapo Inc. |
| Coinsource |
| Coinbase |
| Coinsetter |
| Bittrex |
| Circle |
| Bitstamp |
| MonetaGo |

Examples of Companies which Ceased operations in NY because of the BitLicense

| |
|----------------|
| Korbit |
| Rebit.ph |
| Backpage |
| LocalBitcoins |
| Genesis Mining |
| BitQuick |
| BitMex |
| Kraken |
| Bitfinex |
| GoCoin |
| Poloniex |
| ShapeShift |
| LakeBTC |
| Eobot |
| BTC Guild |

BitLicense Granted:



Source : <http://www.coindesk.com/bitlicense-round-up-whos-left-standing-in-new-york/>

A decorative pattern of various-sized triangles, some solid and some outlined, in shades of red and pink, arranged in a complex, overlapping geometric design along the left and bottom edges of the slide.

Securities Regulation

Securities Regulation: USA

- ▼ The Securities and Exchange Commission Chairman Mary Jo White has stated: *“interests issued by entities owning virtual currencies or providing returns based on assets such as virtual currencies likely would be securities and therefore subject to our regulation”*
- ▼ In *SEC v Trendon T. Shavers and Bitcoin Savings and Trust*, the SEC charged the defendant with running a Bitcoin-denominated securities scam and Ponzi scheme. The SEC claimed jurisdiction based on the Securities Act of 1933 and the Exchange Act of 1934, the cornerstone securities regulations in the United States
- ▼ US District Court for the Eastern District of Texas ruled in favor of the SEC, using a Supreme Court test of an investment contract that: *“is any contract, transaction or scheme involving (1) an investment of money, (2) in a common enterprise, (3) with the expectation that profits will be derived from the efforts of the promoter or a third party”*

Securities Regulation: USA

- ▼ The only controversial point was #1 and the court noted that Bitcoin can be used as money to purchase goods or services or can be exchanged for “conventional currencies” such as USD, Euro, Yen and Yuan while finding for the SEC.
- ▼ The SEC’s statement regarding digital currency and the District Court rulings should be of great interest to “cryptocurrency stock markets” or “cryptocurrency IPOs” which are concepts that are regularly floated in the digital currency area. Certain exchanges do exist in this arena, though not in the United States.
- ▼ This becomes particularly relevant with the advent of meta-coin protocols as Mastercoin, Counterparty and Nxt where securities can be issued by anyone in a decentralized manner.
- ▼ There is no reason to believe that securities denominated in cryptocurrencies would not be subject to the same federal and state securities legislation that all other securities are subject to, including (a) registration of securities, (b) limitations on marketing securities and (c) limitation on ownership of the securities to accredited investors.

Securities Regulation: USA

- Furthermore, it is possible that dealers in these securities would be required to have a broader set of licensing consistent with broker-dealers of traditional securities
- A ruling by the SEC regarding the security offering of Satoshi Dice in 2012-2013, came with a penalty to the issuer and a clear warning by SEC Division of Enforcement Director Andrew Ceresney:

“All issuers selling securities to the public must comply with the registration provisions of the securities laws, including issuers who seek to raise funds using bitcoin”

- It will be interesting to see if other jurisdictions offer more flexible licensing in this regard in an attempt to attract these types of businesses, as crowdfunding for equity or profit shares will most likely remain an important avenue of funding for businesses
- Further afield are concepts like **Decentralized Autonomous Corporations (DACs)** that are independent of any human – these are beyond the scope of this course and will be addressed later in the program

Securities Regulation: Germany

- ▼ An earlier evaluation by German authorities classified Bitcoin as a “unit of account” in September 2013 for taxation and trading purposes.
- ▼ In February 2014, Germany clarified the stance taken earlier by the ministry of finance with a publication from BaFin.
- ▼ In said publication: *“BaFin has qualified BTC with legally binding effect as financial instruments in the form of units of account pursuant to section 1 (11) sentence 1 of the German Banking Act (Kreditwesengesetz – KWG).”*
- ▼ The paper also clarifies 4 activities that need to be licensed by BaFin, if performed with Bitcoin on a commercial level :
 - ▼ Principal Broking Services (Finanzkommissionsgeschäfte)
 - ▼ Multilateral Trading Systems (MTFs)
 - ▼ Investment and Contract Broking (Anlage- und Abschlussvermittlung)
 - ▼ Proprietary Trading (Eigenhandel)

CTFC and commodities regulation

- ▼ In September 2015, The US Commodity Futures Trading Commission (CFTC) has issued its first action against an unregistered bitcoin options trading platform, ordering the startup to cease operations and simultaneously settling the case.
- ▼ With the ruling, the CFTC has also confirmed that bitcoin and other digital currencies are commodities covered by the Commodity Exchange Act (CEA). In the past, CFTC chairman Timothy Massad had stated that bitcoin was likely to be considered a commodity.
- ▼ CFTC director of enforcement Aitan Goelman suggested in a statement that the agency will seek to hold digital currency companies to the same standards as more traditional businesses that fall under its purview.
- ▼ New York Law School professor Houman Shadab, suggested the ruling may have larger implications.
- ▼ "The action puts to rest any notion that virtual currencies qualify as securities. Otherwise, the Securities and Exchange Commission would be bringing this action, not the CFTC," Shadab said.



ERISA / IRA Regulation

Subtitle (optional)



ERISA: USA

▼ **Employee Retirement Income Security Act (ERISA): Prudence**

- ▼ Does not exclude investments in any asset class
- ▼ Fiduciary selecting digital currency as an investment must be “prudent.”

▼ **ERISA: Indicia of Ownership**

- ▼ ERISA plans cannot invest in assets outside of the jurisdiction of the District Courts of the United States (with some exceptions)
- ▼ What are the indicia of ownership of a Bitcoin and where is it located?

▼ **ERISA: Prohibited Transactions**

- ▼ ERISA plans cannot engage in transactions between the plan and a “party of interest”
- ▼ General blind exchanges are probably acceptable under this standard

IRA: USA

▼ Individual Retirement Accounts (IRAs): Collectibles

- ▼ IRAs preclude investments in collectibles, including some collectible coins
- ▼ Despite the similarity in name, it is not likely that cryptocurrencies would be considered collectibles or “coins” in this regard, particularly post the IRS ruling that they are property

▼ IRAs: Commodities / Futures Contracts

- ▼ IRA investments in commodities and futures contracts are permissible
- ▼ This would seem to open the door for similar contracts based on digital currencies

▼ IRAs: UBTI: Unrelated Business Taxable Income

- ▼ IRAs pay taxes on business activity other than passive investments
- ▼ Does not appear that UBTI would be triggered by investing directly in digital currency or through a fund. Investment shares in mining operations might cause a trigger though this is not yet determined.



Special Topics



Indicia of Ownership: USA

- ▼ Indicia of Ownership - in other words - how one can demonstrate that one owns an asset will be a very interesting topic for cryptocurrencies. Beyond its relevance to ERISA, it has relevance to broader institutional adoption of cryptocurrency. For example, how does a hedge fund prove to its auditor that it owns 20,000 bitcoins?
- ▼ Ownership of a bitcoin means “has access to the private key(s) that control certain addresses.” One can prove access to the private key by signing a transaction relating to those addresses.
- ▼ What is more complex however is proving that nobody else has access to those same coins. Imagine that 1 party has shared the private key with two other parties. All three could prove to their auditors that they “own” those bitcoins by signing a transaction.
- ▼ Proposed solutions today involve (1) multi-signature transactions (aka requiring multiple parties to move the coins) along with one or more of the signatories being trusted custodians or trustees or (2) investing through a fund or corporate account (which itself has to solve the issue in #1)

Other Areas: USA

▼ **Fraud, Misrepresentation, Fraudulent Inducement, etc.**

All general criminal and civil statutes that related to fair dealing, theft, fraud, misrepresentation and so on certainly still apply to digital currency related transactions

▼ **CFPB: Consumer Financial Protection Bureau**

The CFPB has a wide-range of consumer protection responsibilities. In related areas, it ensures fees for money transmission are fairly disclosed and that errors can be remediated. It is conceivable it will eventually play a role in digital currency financial services

A decorative pattern of various-sized triangles, some solid and some outlined, in shades of red and pink, arranged in a complex, overlapping geometric design along the left and bottom edges of the slide.

Regulation and Tax treatment – A preview of DFIN-522 (MSc)

A preview of DFIN-522 (MSc)

There's much more to cover with regards to regulation and the tax treatment of digital currencies;
for example:

- ▼ **Regulation** for digital currencies – key theories for regulation and how digital currencies fit in them, application of existing regulations, new regulatory approaches (e.g. BitLicense), self vs. statutory regulation, inherent capabilities of blockchain-based currencies for self-regulation
- ▼ **Taxation** for digital currencies – Anti-Money Laundering (AML) approaches, tax evasion, relation to individual tax system principles, and how direct/indirect taxation could take place
- ▼ **Legislation** for digital currencies – regulation as a function of the legal system, fundamental legal concepts, tax law enforcement related to (or perhaps using) digital currencies
- ▼ Digital currency **uses and business models** – use of Bitcoin exchanges, wallet providers, payment processors, friction points with existing regulations
- ▼ **Issues** for digital currencies – such as in Accounting, Auditing, Custodianship, non-currency blockchain uses, and emerging issues in regulation

All of the above are covered by DFIN-522 Regulation and Digital Currencies from the MSc.

A preview of DFIN-522 (MSc) - Regulation

Key topics explored are:

- ▼ Regulation as a function of the legal system and theories – e.g. role, points of weakness
- ▼ Property and its relevance to digital currencies – e.g. Is Bitcoin a “property”, a “commodity”, a “currency”, etc.
- ▼ Regulation approaches: e.g. Anti-Money Laundering (AML) with examples and related issues,
- ▼ Consumer protection against fraud and theft
- ▼ Study of new regulatory approaches:
 - ▼ Bitlicense
 - ▼ California Bitcoin bill
- ▼ Inherent regulatory capabilities of blockchain-based currencies, self regulation and algorithmic regulation

A preview of DFIN-522 (MSc) - Taxation

Key topics explored are:

- ▼ Tax evasion
- ▼ Tax system principles – e.g. simplicity, transparency, efficiency, etc.
- ▼ How tax laws apply to digital currencies
- ▼ Direct/indirect taxation, how it works and how it is applicable to digital currencies
- ▼ Tax systems approaches and their differences in certain countries, such as, the US, and Australia

A preview of DFIN-522 (MSc) - Legislation

Key topics explored are:

- ▼ Regulation as a function of the legal system
- ▼ Fundamental legal concepts – e.g. with regards to “property” (Common law and European legal codes)
- ▼ Tax law enforcement
- ▼ Study of existing legislation in relation to digital currencies:
 - ▼ US-related such as US Constitution, Electronic Funds Act, Patriot Act, California bill AB-129, etc.
 - ▼ Key US regulators such as SEC, CFTC, CFPB, etc.
 - ▼ Australia-related such as Australia Securities and Investments Commission
 - ▼ Other existing legislation in Canada, the UK, Singapore

A preview of DFIN-522 (MSc) – Other Issues

Key topics explored are:

- ▼ Issues relating to “property” (e.g. liens and charges, US Uniform Commercial Code (UCC), etc.)
- ▼ Issues in Accounting, Auditing and Custodianship of digital currencies
- ▼ Issues in Securities, Pensions, and Succession
- ▼ Non-currency blockchain uses and different business models
- ▼ Distributed ledgers
- ▼ Emerging issues in the regulation of digital currencies

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Conclusions

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Conclusions

- ▼ The Financial services industry is a very highly regulated industry. Given that there is no particular reason that changing the denomination of a financial services activity or instrument to digital currency would invalidate this regulation, it is likely that in most countries the full panoply of financial services regulation will be applicable to at least some parties in the cryptocurrency ecosystem
- ▼ Decentralized digital currencies share characteristics of currency, property, commodities and money transmission networks. This creates challenges in neatly matching them to pre-existing categories.
- ▼ The regulatory environment is still uncertain on a global basis as most countries have not yet given detailed guidance across the board about how digital currency should be treated. The US is furthest along of major economies, but it is anticipated that the EU will be presenting a common point of view soon. Countries with capital controls have been the most negative for obvious reasons.
- ▼ The greatest variety of approaches has been seen in taxation approaches to digital currency, ranging from standard “property” treatment to no taxation at all
- ▼ It will be interesting to see which countries provide accommodations (permanent or temporary) to digital currency to allow for early adoption or development



Further Reading



Further Reading 1/3

▼ IRS Notice: 2014-21

▼ <http://www.irs.gov/pub/irs-drop/n-14-21.pdf>

▼ Investopedia Guide to Bitcoin Taxation

▼ <http://www.investopedia.com/university/definitive-bitcoin-tax-guide-dont-let-irs-snow-you/>

▼ HRMC Revenue and Customs Brief 9/14:

▼ <http://www.hmrc.gov.uk/briefs/vat/brief0914.htm>

▼ FIN-2014-R001:

▼ http://www.fincen.gov/news_room/rp/rulings/pdf/FIN-2014-R001.pdf

▼ FIN-2014-R012:

▼ http://www.fincen.gov/news_room/rp/rulings/pdf/FIN-2014-R012.pdf

▼ SEC 2013-132:

▼ <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539730583#.U1XsofldUt0>

Further Reading 2/3

▼ Regulatory map for Bitcoin

- ▼ MerkleTree.io

▼ UK Treasury digital currencies regulation

- ▼ <https://www.gov.uk/government/consultations/digital-currencies-call-for-information>

▼ Brazil digital currencies regulation

- ▼ <https://www.bitcoinbrasil.com.br/como-declarar-seus-bitcoins-no-imposto-de-renda-de-2015>
- ▼ <https://www.coindesk.com/brazil-central-bank-chief-compares-bitcoin-pyramid-scheme/>

▼ Australia digital currencies regulation

- ▼ <http://www.rba.gov.au/speeches/2015/sp-so-2015-04-07.html>
- ▼ <http://www.abc.net.au/news/2017-10-23/bitcoin-one-step-closer-to-being-regulated-in-australia/9058582>

▼ Denmark digital currencies regulation

- ▼ <http://www.finanstilsynet.dk/da/Nyhedscenter/Pressemeddelelser/2013/Advarsel-mod-virtuelle-valutaer-bitcom-mfl-2013.aspx>

▼ Bolivia digital currencies ban

- ▼ <https://bitcoinmagazine.com/articles/bolivian-authorities-arrest-60-cryptocurrency-promoters/>

▼ Ecuador Bitcoin use grows despite 2014 ban

- ▼ <https://news.bitcoin.com/use-bitcoin-ecuador-grow-government-ban/>

Further Reading 3/3

▼ Finland digital currencies regulations

- ▼ [http://www.vero.fi/sv-FI/Detaljerade_skatteanvisningar/Inkomstbeskattning_av_personkunder/Inkomstbeskattning_av_virtuella_valutor\(28454\)](http://www.vero.fi/sv-FI/Detaljerade_skatteanvisningar/Inkomstbeskattning_av_personkunder/Inkomstbeskattning_av_virtuella_valutor(28454))

▼ China's exchanges closure affects price

- ▼ <https://www.cnn.com/2017/09/11/bitcoin-price-falls-on-reports-that-china-is-closing-local-exchanges.html>

▼ Japan digital currencies regulations

- ▼ <https://bravenewcoin.com/news/bitcoin-regulation-overhaul-in-japan/>

▼ Russia's plans as a result of meeting between regulators and Putin

- ▼ <https://news.bitcoin.com/putin-confirms-russia-regulate-cryptocurrencies/>

▼ France potential regulations on ICOs

- ▼ <https://www.coindesk.com/france-close-issuing-position-icos/>

▼ The latest Bitlicense (June 2015) explained:

- ▼ <http://www.morganlewis.com/pubs/nydfs-releases-final-rules-for-licensing-virtual-currency-businesses-in-new-york>

▼ Further Bitlicense comments:

- ▼ <http://www.coindesk.com/new-york-releases-final-bitlicense/>
- ▼ <http://www.coindesk.com/bitlicense-divisive-milestone-bitcoin-regulation/>

▼ IRS' collaboration with Chainalysis

- ▼ <https://www.cryptocoinsnews.com/irs-tracked-bitcoin-tax-evaders-since-2015/>



Questions?

Contact us!





UNIVERSITY *of* NICOSIA

Twitter: @mscdigital

Course Support: digitalcurrency@unic.ac.cy

IT & live session support: dl.it@unic.ac.cy