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# Cryptocurrency and Blockchain: Regulatory Concerns & Municipal Finance Possibilities

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# Speaker

- Stevie leads Wolters Kluwer's Compliance Solutions business's Fintech Task Force and manages several of its regulatory compliance software and service businesses
- Has spoken and co-authored several articles on blockchain and cryptocurrency tax and regulatory issues

# Crypto & Blockchain 101

- What is Blockchain?
  - Technological medium
  - Analogous to tracks on which trains run
  - Each “block” of data is “chained” to others
  - Distributed ledger, consensus verification

# What is Cryptocurrency?

- Digital store of value on a blockchain
- Satoshi and Bitcoin
- Ethereum and smart contracts/distributed apps
- Analogous to trains on tracks – various types
- Proof of Work vs. Proof of Stake
- Benefits of distributed ledger

# What are ICO Tokens?

- Token issuance/presale, often for Bitcoin/Ether
- Alternative method of raising funds
  - To develop project or digital ecosystem
- Generally tradable in secondary market
- Can typically be exchanged for new digital asset (or coin) in future

# What Drives Adoption?

- *Rejection of Traditional Finance*
- *Increased speed and lower costs*
- Decentralization & Self-Verification
- Other Technological Reasons

# Regulatory Concerns

- AML
- Securities Regulation
- Commodities Regulation
- Tax Considerations

# AML

- Are crypto/tokens subject to Federal AML law?
- FinCEN says yes
- MSB and other compliance Issues
- Liberty Reserve and the “death penalty”
- Ripple Labs & BTC-e enforcement actions



# FinCEN Director Blanco Statements

- 2018 Chicago-Kent Block (Legal) Tech:
  - Individuals/entities engaged in business of accepting and transmitting convertible virtual currency
  - FinCEN will aggressively pursue those who target victims or those who enable

# Securities Regulation

- Are cryptos/tokens subject to Fed. SEC regs?
- *Howey Test* (328 US 293 (1946))
  - Arrangement where (1) money or assets invested in a common enterprise (2) with the expectation of profit (3) from efforts of promoter or third party
- Uber aggressiveness and rejection of status quo

# SEC Statements

- DAO Tokens were securities
- Where Howey test met, digital assets probably securities (“*When Howey Met Gary Plastic,*” Director Hinman, June 2018)
- Analysis can change over time

# SEC Litigation

- Blockvest – not a security - tokens weren't actually offered for sale (no investment)
- Celebrities (Floyd Mayweather, DJ Khalid)
- False advisor/pump and dump scams
- Kik Interactive wants to litigate

# Commodities Regulation

- MyBigCoin (Dist. Ct. Mass. (Sept. 26, 2018))
- Joint CFTC/SEC statements
- Same digital asset can be security when offered, commodity after offering completed

# Tax Treatment

- Little IRS guidance (Notice 2014-21)
- IRS has indicated they intend to enforce taxpayer compliance on reporting crypto gains (IR-2018-71, Mar. 23, 2018 & LBI announcement, July 2, 2018)
- Taxation of “forks” is an issue

# Notice 2014-21

- Intangible property, not currency
- Track unique basis of each lot
- Gains and losses incurred whenever exchanged

# Open Questions

- Do wash sale or straddle rules apply?
- Do other loss limitation rules apply?
- Were like-kind exchanges nontaxable (pre-2018)
- Taxation of forks – analogies to animal cases



# Crypto Federal Legislation – 115th

- 115<sup>th</sup>: HR 3708 (Bill): Excludes \$600 in VC gain
- 115<sup>th</sup>: HR 88 (Act): Proposed amendment included \$600 de minimis – absent from final
- 115<sup>th</sup>: HR 6973 (Bill): Provided safe harbor for hard fork taxes through beginning of 2017
- 115<sup>th</sup>: HR 6974 (Bill): Prevented blockchain business treatment as a “money transmitter”

# Crypto Federal Legislation – 116th

- 116<sup>th</sup>: HR 56 (Act): Terrorism & Illicit Financing VC Task Force with rewards
- 116<sup>th</sup>: HR 502 (Act): Study on Use of VC & OL MP to facilitate financing of S&D trafficking

# Municipal Finance Possibilities

# Blockchain Bonds Generally

- World Bank – announced Aug, 2018
  - Commonwealth Bank of Australia
- BNP Paribas Minibonds – reported to be in development since 2016
  - Also trialed blockchain-based funds distribution
- SEC Rule 15c3-3 custodyship issues with blockchain-based investments
- Potential benefits

# Berkeley, California

- Voted to move forward with pilot May, 2018
- Would lower threshold for investment
- Denver, CO and Cambridge, MA have issued “mini-bonds” before – crypto is new wrinkle
- Small projects don’t need to be “bundled”

# Blockchain Minibonds

- **Benefits:**
  - 42% lower cost of issuance via elimination of broker/dealer and custodian fees
  - Increased transparency regarding use of proceeds
  - Access to different pools of lenders due to “mini” bonds and “micro” denomination flexibility (potential elimination of \$5k minimum denomination)
- **Risks: Loss of benefits of broker/dealer participation**

# Muni-Finance Issues

- SEC Rule 15c3-3 custodyship issues with blockchain-based investments
- Payments valued in crypto
  - Tax issues include CPDI rules
- Payments payable in crypto
  - Other tax issues
- Emerging fraud issues w/crypto

# Displacement Risks

- Stated purpose of crypto generally (and Berkeley minibond issuance) is to eliminate middlemen and reduce fee overhead
- Custodial?
- Related Fees?



# Conclusion