

Accounting & Legal Implications of Cryptocurrency and Blockchain

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You've all heard it:

- Blockchain is a “game changer” (Deloitte, 2018)
- Blockchain is one of the most important and innovative technologies developed in recent years (Dai and Vasarhelyi, 2017; Peters and Panayi, 2016; Pilkington, 2016; PwC, 2015; Swan, 2015)

Agenda

- Accounting Information System Adoption
- Potential Accounting Process Automation
- Cryptocurrency Regulation in the US
- Cryptocurrency Regulation at the latest Consortium

Blockchain as Accounting Information System?

- Blockchain principles: Distributed database, peer-to-peer transmission, transparency, irreversibility of records, computational logic (Tapscott and Tapscott, 2017)
- Permissioned Blockchain is option with some drawbacks (Dai and Vasarhelyi, 2017; Coyne and McMickle, 2017)
 - Pro: Privacy
Authorization
Scalability
 - Con: Trust
Governance
- More like traditional systems with different technologies

Accounting Processes Automated

- **Payments** (Percy, 2017; Baron, 2017; Dai and Vasarhelyi, 2017)
- **Invoicing** (Baron, 2017; Dai and Vasarhelyi, 2017)
- **Contracts/Documentation** (Baron, 2017; Dai and Vasarhelyi, 2017; Morehouse, 2017)

Consider the amount of complexity and coordination required along with the degree of novelty of the task (Iansiti and Lakhani, 2017)

Blockchain Adoption Challenges

- Technology and Organizational Processes that are not mature enough to work with Blockchain, Integration with Legacy Cost (Percy, 2017)
- Getting the right people to implement strategy (Percy, 2017; Dai and Vasarhelyi, 2017)
- “It is not clear that Blockchain, which was designed to solve another specific problem, would be any better than a traditional ERP system in tracking accounting transactions.” (Coyne and McMickle, p.109)

Legal Review

Federal View

- On the Mind:
 - Senate Banking Committee
 - Hearing about the need for oversight of digital currencies
 - FASB
 - Continued research on how cryptocurrency and blockchain may impact financial reporting (Boring, 2017)
- Current Laws
 - Nexus: A point of causal intersection, link, relation, connection.
 - *Black's Law Dictionary* ("Definition of NEXUS (Black's Law Dictionary)," 2012)

Federal View - CFTC

- Approve the Chicago Mercantile Exchange Group to trade bitcoin futures in December, 2017 (Dodd-Frank, 2010)
- Compliance through “Self-Certification” (Dodd-Frank, 2010)
 - Exchange pledges the new instruments will not break any federal law

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17. OTHER INCOME, NET

Other income, net consisted of the following

	Years ended December 31,		
	2017	2016	2015
Gain on sale of <u>cryptocurrencies</u>	\$ 4,816	\$ —	\$ —
Club O Rewards and gift card breakage	2,742	16,808	5,911
Gain (loss) on investment in precious metals	1,971	201	(1,183)
Ineffective portion loss of cash flow hedge	—	—	(124)
Other	(400)	22	(970)
Early extinguishment costs of long term debts	(2,464)	—	—
Loss on impairment of cost method investments	(5,487)	(2,850)	—
Total other income, net	<u>\$ 1,178</u>	<u>\$ 14,181</u>	<u>\$ 3,634</u>

Our decision to accept and hold cryptocurrency, such as bitcoin, may subject us to exchange risk and additional tax and regulatory requirements.

In January 2014, we began accepting bitcoin as a form of payment for purchases on our website, and we now accept approximately 50 different cryptocurrencies.

(Overstock, 2017)

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Disclosures

- **Cryptocurrencies**

- Lower of cost or market based on an average unit cost
 - Decreases recognized on an interim basis
 - Increases during same fiscal year recognized in the later interim period, not in excess of previously recognized decrease during the same year.
 - Unrealized gains and losses recorded in Other income.
 - Realized gains and losses upon sale also recorded in Other income.

For Goods & Services – Overstock

Disclosures

- **Our decision to accept and hold cryptocurrency, such as bitcoin, may subject us to exchange risk and additional tax and regulatory requirements** (Overstock, 2017)
 - Not considered legal tender or back by any government
 - Price volatility, technology glitches, various law enforcement and regulatory interventions.
 - Prohibited or effectively prohibited in some countries.
 - Compliance failure = regulatory or enforcement actions, potential fines and other consequences.
 - Hold bitcoin up to 50% of sales revenue paid in bitcoin.
 - Potential limitations on hedging
 - Potential significant monetary losses as well as future licensure or regulatory approval could have materially adverse effect on financial results and business.

For Goods & Services – Overstock

Disclosures

- **The potential application of U.S. laws regarding virtual currencies and money transmission to PRO Securities' use of the Bitcoin blockchain is unclear** (Overstock, 2017)
 - Exchanging or otherwise using virtual currencies under state and federal laws may require:
 - Licensing
 - Registration
- Potential Criminal Offense
- tZERO Platform used and parties operating it (Overstock, 2017)
 - Not licensed under virtual currency or money transmission regulations of any state.
 - Not registered with Financial Crimes Enforcement Network (FinCen)

Federal View - FinCEN

- Administrators and Exchangers of virtual currency are **money transmitters** under existing regulation requiring registration with **FinCEN** (Tankersley, Davis, and Loy, 2017)
 - United States Department of the Treasury Financial Crimes Enforcement Network (FinCEN), 2013
 - Virtual Currency Complaints submitted to United States Financial Protection Bureau (CFPB) justifying the view.

Federal View – FinCEN Implications

- Registration with FinCen
- Keep Records
- Report Suspicious Transactions
 - Money Laundering
 - Terrorist financing abuse
 - Know your customer
- The finance regulatory intent is to focus on individuals facilitating “entry and exit into a convertible virtual currency system.”

Federal View - SEC

- "Security" means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.
 - 15 USCS § 80a-2(36)

Federal View - SEC

- A transaction is an investment contract or **security**, if “a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”
 - SEC v. W.J. Howey Co., 328 U.S. 293 (1946)

Federal View - SEC

- The SEC applies longstanding securities law principles “to demonstrate that a particular token constituted an investment contract and therefore a security under our federal securities law.”
 - SEC Chairman Jay Clayton statements regarding SEC’s 21(a) Report (Release No. 81207 July 25, 2017).
December 11, 2017

Federal View – SEC Implications

- Securities Act of 1933
- Securities Exchange Act of 1934
- Investment Company Act of 1940
- Investor Protection Provisions
- Anti-Money Laundering obligations
- Know Your Customer obligations
- Accounting, Audit, and Reporting Requirements

Federal View – SEC Warnings

- Market Professionals:
 - Launching cryptocurrency or other product where value is tied to cryptocurrencies, promoters must either:
 - Be able to demonstrate that the currency or product is NOT a security OR
 - Comply with applicable registration and other requirements under securities law.
 - Excessive touting in thinly traded and volatile markets can be an indicator of “scalping,” “pump and dump” and other manipulations and fraud.
 - 21(a) Report (Release No. 81207 July 25, 2017)

Federal View – SEC Warnings

- Market Professionals:
 - Allow payment with cryptocurrency, purchase cryptocurrency on margin, or use cryptocurrency to facilitate securities transactions
 - Use caution ensuring activities don't undermine anti-money laundering and know-your-customer obligations
 - 21(a) Report (Release No. 81207 July 25, 2017)

Federal View – SEC Warnings

- Main Street Investors:
 - No initial coin offerings registered with SEC
 - S-1 filed in March 2018 for The Praetorian Group
 - Excessive touting in thinly traded and volatile markets can be an indicator of “scalping,” “pump and dump” and other manipulations and fraud.
 - Ask questions and DEMAND clear answers
 - HoweyCoins.com

Federal View – SEC Enforcement

- “This is a reminder that investors should give heightened scrutiny to penny stock companies that have switched their focus to the latest business trend, such as cryptocurrency, blockchain technology, or initial coin offerings . . .”
 - SEC Director of the Los Angeles Regional Office regarding February 2018 suspended trading in three companies.
 - Suspends trading stock for 10 days
 - Prohibits soliciting of investors to buy or sell stock until reporting requirements met

Federal View – SEC Enforcement

- Myriad Interactive Media, Inc – Trade Suspension December, 2014
- Recoin Group and Diamond Reserve Club – Freeze assets September, 2017
- AriseBank – Freeze assets, temporary restraining order January, 2018
- Longfin – Freeze on stock sales April, 2018

Federal View - IRS

- Virtual Currency transactions are taxable just as any other property transaction.
 - Internal Revenue Service, 2014

Federal View – IRS Implications

- Failure to Report Consequences
 - Payment
 - Tax Due + Penalties + Interest
 - Criminal Charges (tax evasion and filing a false tax return)
 - Prison term
 - Fine up to \$250,000 each

State



Bitcoin not money, Miami judge rules in dismissing laundering charge

- *Miami Herald* July 25, 2016

State View

- **Statute Amendments**
 - Laundering Statutes
 - State Money Transmission Statutes
 - Unclaimed Property
 - Taxes (Tankersley, 2017)
- **Current Statute Application**
- **Licensure**
- **New/Proposed Legislation**

“Friendly” States

- Nevada
 - Rejected regulation and imposition of tax burdens
- Wyoming
 - Wyoming Blockchain Coalition (Tankersley, 2017)

Uniform Regulation of Virtual Currency Business Act

- Proposed by Uniform Law Commission
 - Clearly defines virtual currency business activity
 - Pertains specifically to virtual currency
 - Will make the law substantially the same among states
 - Nearly forces state regulatory agencies to cooperate
 - Does still have limitations (Miller, 2018)

URVCBA

- Under URVCBA
 - “users” are not money service businesses and are not subject to BSA regulations
 - “administrators” and “exchangers” are money services business and are subject to MSB registration (Miller, 2018)

Adoption of URVCBA

- Hawaii, California, and Connecticut
 - Working on legislation to adopt (Miller, 2018)
- Nebraska
 - Adoption failed (Miller, 2018)

Questions/Comments

Thanks for Listening

Questions/Comments

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