

The Blockchain Ledger

LINKING ASSETS INC.

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In this Ledger



What Is Virtual Currency, Part 3



Highlights: News & Developments

Linking Assets Inc. publishes *The Blockchain Ledger* with articles and information regarding blockchain, cryptocurrency, virtual currency, digital assets, etc. and their intersections with state unclaimed property laws. Keeping you informed of pertinent unclaimed property implications and related developments.

What is Virtual Currency, Part 3

By [Christa DeOliveira](#) & [Ari Mizrahi](#)

States are updating unclaimed property laws to include virtual currency. In Part 3 of this series, we explore the SEC's and the IRS' views on virtual currency. (Parts 1 and 2 are available on Linking Assets' [NEWS](#) page.)

SEC: Through a variety of statements¹, speeches², and letters³ the SEC has made clear the application of the Howey Test must be used to determine if a crypto currency is a security. The "Howey Test" was created by the Supreme Court in *SEC v. W. J. Howey Co.* (1946) and is used to determine whether specified instruments/ transactions qualify as "investment contracts." If they do, then under both the Securities Act of 1933 and the Securities Exchange Act of 1934, those specified

transactions are indeed considered securities and are subject to disclosure and registration requirements.

On November 19, 2020, SEC Chairman Jay Clayton said, "We determined that bitcoin was not a security, it was much more a payment mechanism and stored value."⁴

By contrast, in the recent action against Ripple, the SEC alleges Ripple "engaged in an illegal securities offering from 2013 to the present."⁵ The complaint states, "Ripple never filed a registration statement, it never provided investors with the material information that every year hundreds of other issuers include in such statements when soliciting public investment." The complaint further asserts Ripple engaged "in the unlawful offer and sale of securities in violation of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77e(a) and 77e(c)]."⁶

According to Investopedia, "An initial coin offering (ICO) is the cryptocurrency industry's equivalent to an initial public offering (IPO)."⁷ A company can raise money to create a new coin, app, or service as an ICO. Interested investors can buy into a cryptocurrency token offering. These tokens could have some use related to the product/service or could simply represent a stake in the issuer or project.

IRS: Likewise, the IRS has answered "What is Virtual Currency?" in publications:

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like "real" currency (i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance), but it does not have legal tender status in any

¹ <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>, Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, December 11, 2020

² Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, June 14, 2018 <https://www.sec.gov/news/speech/speech-hinman-061418>

³ <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>

⁴ <https://twitter.com/squawkcnbc/status/1329420012080295939?lang=en>

⁵ <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-338.pdf>, *Securities and Exchange Commission v. Ripple Labs, Inc., Bradley Garlinghouse, And Christian A. Larsen*

⁶ *Ibid*

⁷ <https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp>

jurisdiction. Cryptocurrency is a type of virtual currency that utilizes cryptography to validate and secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as “convertible” virtual currency. Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies.

Further, the IRS notifies the “sale or other exchange of virtual currencies, or the use of virtual currencies to pay for goods or services, or holding virtual currencies as an investment, generally has tax consequences that could result in tax liability.”⁸

There is an IRS Frequently Asked Questions⁹ publication relating to individuals’ virtual currency transactions. Expressly, those holding cryptocurrency as capital assets and those not engaged in the trading or business of selling cryptocurrency.

The FAQ outlines how virtual currency is treated for Federal income tax purposes.¹⁰ It specifies virtual currency is considered property; therefore, general tax treatment applicable to property transactions apply.¹¹

Looking at the differing definitions noted in Parts 1, 2, and 3 of this series (Parts 1 and 2 can be found [here](#)) begins to paint the picture of why there is confusion. Will regulatory clarity and consistency emerge?

Please look forward to future installments in this series and other upcoming articles on blockchain, cryptocurrency, virtual currency, digital assets, etc. and their intersections with state unclaimed property laws. If you seek more information on blockchain, virtual currency, or unclaimed property, contact the authors of this article series, [Christa DeOliveira](#) or [Ari Mizrahi](#).



Highlights: News & Developments

With the proliferation of events and news in this sector, this section simply seeks to contain a few relevant highlights. We also include information on our [NEWS](#) page and [LinkedIn](#) and invite you to follow us.

Conversion of Anchorage Trust Company to Anchorage Digital Bank: on the heels of the *OCC Issues Interpretive Letter 1174*,¹² the OCC conditionally approved a charter, making Anchorage the first US national digital asset bank.¹³ More on the *OCC Issues Interpretive Letter 1174* is available in Linking Assets Inc.’s *The Blockchain Ledger January 7, 2021*.¹⁴

Mobility Open Blockchain Initiative (MOBI) started an initiative to track car registrations and histories on the blockchain, to reduce used vehicle fraud.

Vehicle registration on blockchain allows formerly disconnected vehicle registration systems between states and countries to connect using a secure, shared, and trusted ledger. Maintenance traceability will provide a tamper-proof history to buyers, regulators, and insurers.¹⁵

The working group on the initiative is co-chaired by BMW and Ford, with members including Honda, IBM, Hitachi America, Quantstamp and others.

Financial Advisors Warm to Crypto in the Bitwise/ETF financial advisor attitudes toward crypto trends survey¹⁶ cited an almost 50% increase in financial advisors allocating to crypto during 2020 compared to the prior year. In 2020, 81% of financial advisors report getting client questions on crypto, up from 76% in 2019.

IRS continues scrutiny on virtual currency to ensure it is not used for tax evasion or other illegal activity. As reported throughout 2020 the IRS has contracted with specialists to undertake cryptocurrency cases. The IRS is looking for those not reporting profits from trading and those using cryptocurrencies for illegal activity.¹⁷

The IRS recently mailed crypto compliance warning letters and moved the 2019 virtual currency question

⁸ IRS Notice 2014-21, IRB 2014-16, guidance for individuals/businesses on the tax treatment of transactions using virtual currencies.

https://www.irs.gov/irb/2014-16_IRB#NOT-2014-21

⁹ <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>

¹⁰ Ibid

¹¹ Details on the tax treatment of property transactions is available in the Sales and Other Dispositions of Assets, Publication 544 <https://www.irs.gov/forms-pubs/about-publication-544>

¹² <https://www2.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2a.pdf>

¹³ <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-6.html>

¹⁴ <https://www.linkingassets.com/update-newsletter/The%20Blockchain%20Ledger%2001.07.2021.pdf>

¹⁵ <https://cointelegraph.com/news/ford-bmw-back-blockchain-birth-certificates-to-combat-used-car-fraud>

¹⁶ <https://www.bitwiseinvestments.com/resources/press-releases/bitwise-etf-trends-release-results-of-2021-survey-of-financial-advisor>

¹⁷ <https://fortune.com/2020/09/28/the-irs-is-adding-a-cryptocurrency-question-to-form-1040-for-2020/>

from form 1040 schedule 1 to the front page of form 1040, directly below name and address. The question is “At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?”¹⁸

Is there a cryptocurrency inaccurate or incomplete narrative we are hearing from key regulators? A preview excerpt of the *Chainalysis 2021 Crypto Crime Report* cites \$10 billion was sent and received by criminal enterprises:¹⁹

In 2019, criminal activity represented 2.1% of all cryptocurrency transaction volume, or roughly \$21.4 billion worth of transfers. In 2020, the criminal share of all cryptocurrency activity fell to just 0.34%, or \$10.0 billion in transaction volume.²⁰

Scams made up the largest part of the illegal activity at 54%. Darknet markets were the second biggest criminal category. Ransomware was up to 7%, this represents a 311% increase over the prior year.²¹

Obviously, cryptocurrencies are used for illicit activities and regulation is needed. However, it remains a drop in the bucket when compared with traditional financial services. In 2018, the United Nations Office of Drugs and Crime estimated that “more than \$2 trillion is made in annual proceeds from illicit activities.”²²

SHAPING POLICY *Janet Yellen* President Biden’s pick for *Secretary of the Treasury* said cryptocurrencies are “a particular concern” when it comes to terrorist financing on January 19, 2021 at a confirmation hearing. She also said, “I think many [cryptocurrencies] are used, at least in a transaction sense, mainly for illicit financing. And I think we really need to examine ways in which we can curtail their use, and make sure that anti-money laundering doesn't occur through those channels.”

European Central Bank President Christine Lagarde calls for global regulation of Bitcoin and to close loopholes that allow for money laundering. She had strong words for what she referred to as “funny business.”²³

Gary Gensler nominated to head the SEC. Gensler is a former chairman of the Commodity Futures Trading Commission (CFTC) and has taught on cryptocurrencies and blockchains at MIT. In 2018 at a Business Blockchain conference at MIT Gensler stated, “There really is significant non-compliance with respect to the laws, certainly in this country... other countries as well,”²⁴ referring to non-compliance with current laws. Like many others, he has predicted future pains from growing regulations. What initiatives and regulatory measures will be pursued at the SEC under the new administration remain to be seen.

Commissioner of the SEC, Hester Peirce, this week at the Crypto Finance Conference said, “We really need to embrace innovation, and figure out how we can set up a regulatory environment that’s conducive to innovation, which I think in our space means providing clarity.”²⁵ She discussed working with a SEC chairman and expressed hopes of providing some “safe harbor”²⁶ for the cryptocurrency space.

By contrast, outgoing Acting Comptroller of the Currency, Brian Brooks, astutely recommends solving technology challenges with technology.²⁷ In an Op-Ed piece published on January 12, 2021, Brooks compares the prediction and progression of self-driving cars to decentralized finance (DeFi). He contemplates a future where regulators “even grant a national bank charter to open-source software that manages deposit-taking, lending, or payments.”²⁸ He notes that in the “absence of federal regulatory clarity... a patchwork of inconsistent rules” could hinder the developing a national market.²⁹



¹⁸ <https://www.irs.gov/pub/irs-pdf/f1040.pdf>

¹⁹ <https://blog.chainalysis.com/reports/2021-crypto-crime-report-intro-ransomware-scams-darknet-markets>

²⁰ The article notes, “One reason the percentage of criminal activity fell is because overall economic activity nearly tripled between 2019 and 2020.”

²¹ Ibid

²² <https://bitcoinist.com/the-dollar-far-outstrips-cryptocurrency-in-illicit-activity-spending/>

²³ <https://www.coindesk.com/european-commission-ecb-unite-to-consider-potential-pitfalls-of-the-digital-euro>

²⁴ <https://www.coindesk.com/fear-hodling-mit-blockchain-experts-weigh-impact-sec-crackdown>

²⁵ <https://cointelegraph.com/news/sec-s-crypto-mom-demands-innovation-says-you-can-t-prosecute-an-algorithm>

²⁶ Safe Harbor status to crypto launches would grant projects an initial 3-year window during which regulatory liability would be ramped up gradually for the purpose of fostering innovation, <https://cointelegraph.com/news/sec-s-crypto-mom-demands-innovation-says-you-can-t-prosecute-an-algorithm>

²⁷ <https://www.elliptic.co/webinars-events/financial-regulator-crypto-coffee-webinar-series-with-brian-brooks-occ>

²⁸ <https://www.ft.com/content/c1caca5b-01f7-41be-85a4-3ecb883f2417>

²⁹ Ibid