

# Bitcoin and the Brave New World of Cryptocurrency

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AFP Arizona

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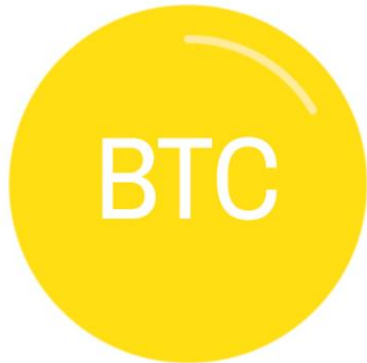


# What is bitcoin?

Bitcoin is a “cryptocurrency” that was created in 2009 by an unknown person or persons using the alias Satoshi Nakamoto. Transactions are made without the need for an intermediary – meaning, no banks! There are almost no transaction fees and no need to verify your identity. More merchants are beginning to accept them.



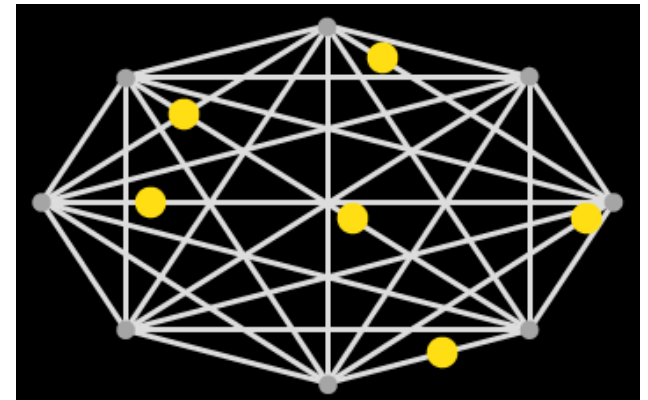
# Bitcoin Basics



- ❖ Building Blocks to Understanding:
  - Open Source Software
  - Decentralized, Peer-to-Peer Network
  - Monetary Theory (scarcity, value, currency)
  - Cryptography

# Why Bitcoin?

Bitcoins can be used to buy merchandise quasi-anonymously. International payments are easy and cheap because bitcoins are not tied to any country or subject to regulation. Small businesses may like them because there are no credit card fees. Some people buy bitcoins as an investment.



# Acquiring Bitcoin

After downloading open-source software (or third-party interface):

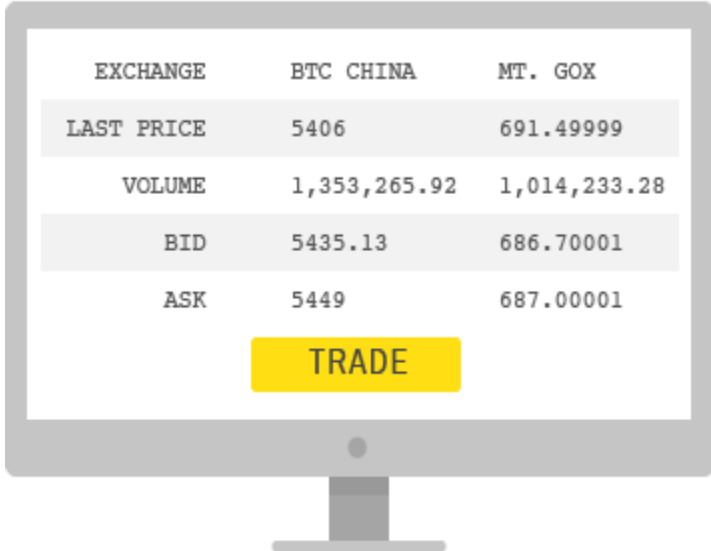
1. Buy on an Exchange.
2. Accept as currency in exchange for goods or services.
3. Mining.

# Acquiring Bitcoin

## 1. Buy on an Exchange:

Several marketplaces called “bitcoin exchanges” allow people to buy or sell bitcoins using different currencies.

Mt. Gox was the largest exchange.



EXCHANGE	BTC CHINA	MT. GOX
LAST PRICE	5406	691.49999
VOLUME	1,353,265.92	1,014,233.28
BID	5435.13	686.70001
ASK	5449	687.00001

TRADE

# Bitcoin Exchange

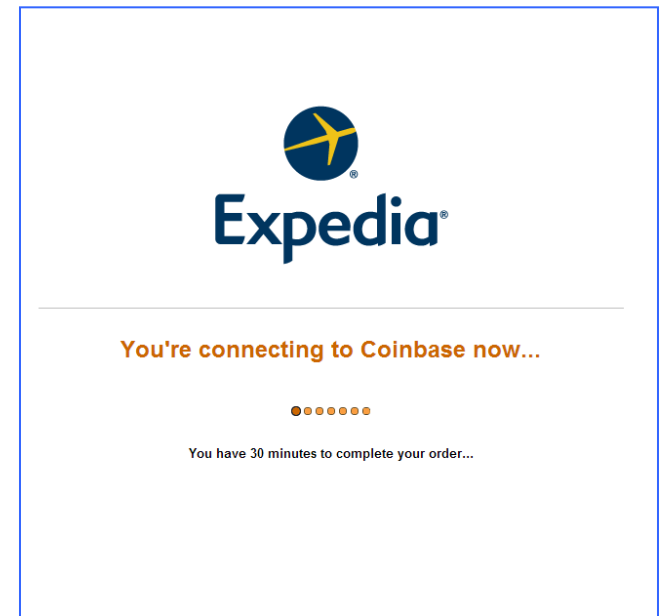
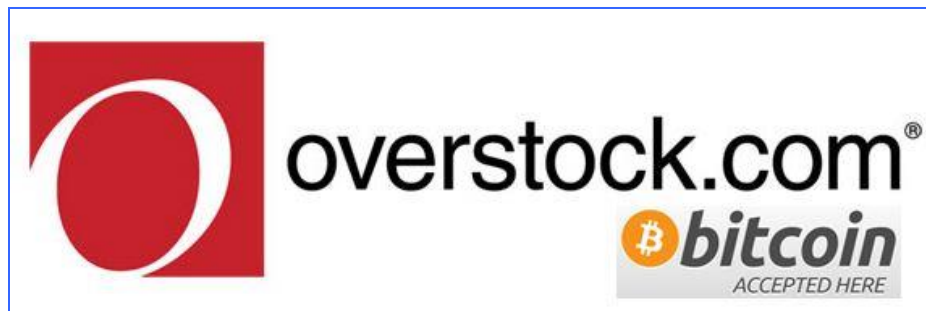
Coinbase launched in January 2015, as the first U.S.-based bitcoin exchange. It is backed by serious investors and the NYSE.



# Acquiring Bitcoin

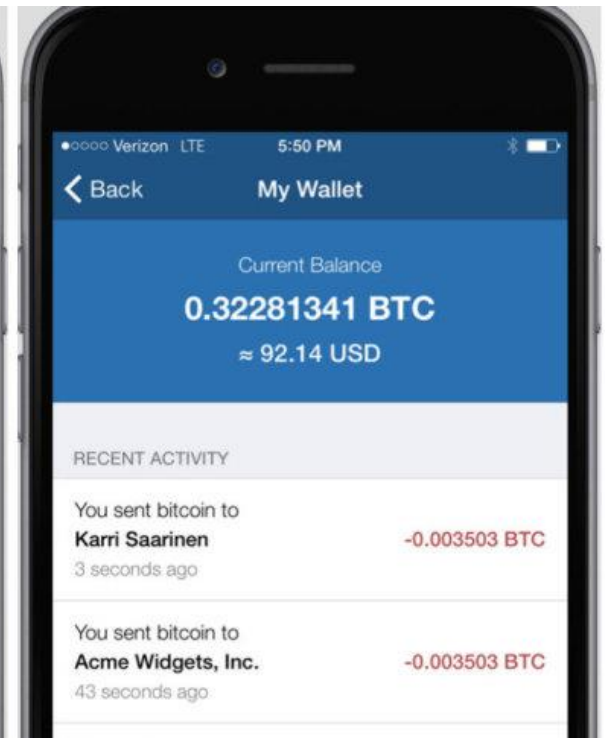
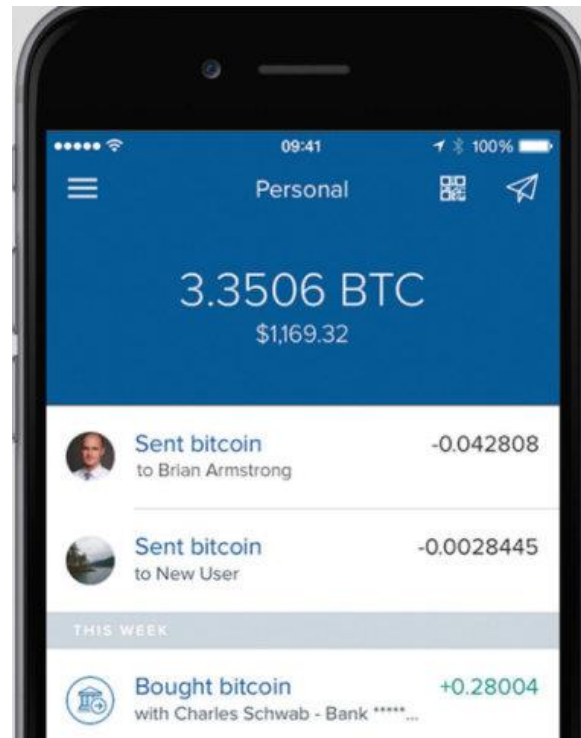
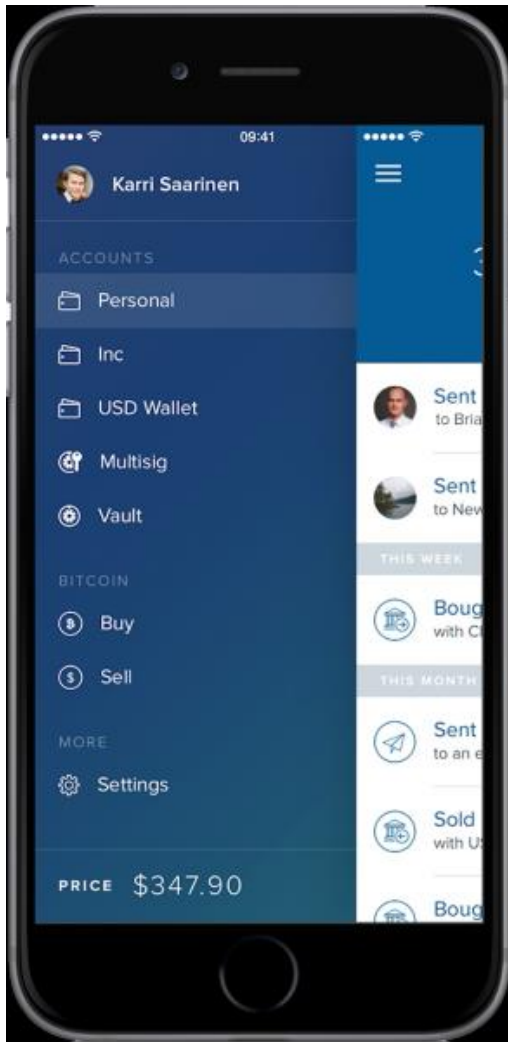
## 2. Accept as Payment:

Sell something in exchange for Bitcoin.





# The Bitcoin Wallet



# Accept Bitcoin as Payment


## 🛒 Pay With Bitcoin ×

Pay  USD to Admin User for Bitcoin Foundation.

Choose amount:  \$1  \$5  \$10  \$50  \$100

[Send using a Coinbase.com account](#)

[Send using a bitcoin address](#)



Send exactly 0.057975 BTC to:  
`n31tuSqM9uMgJPHJbTcVjDRa6PCrMCrm2t`

After sending to the above address click 'Confirm Payment' below.

[Don't have any bitcoin?](#)

# Acquiring Bitcoin

## 3. Mining Bitcoin

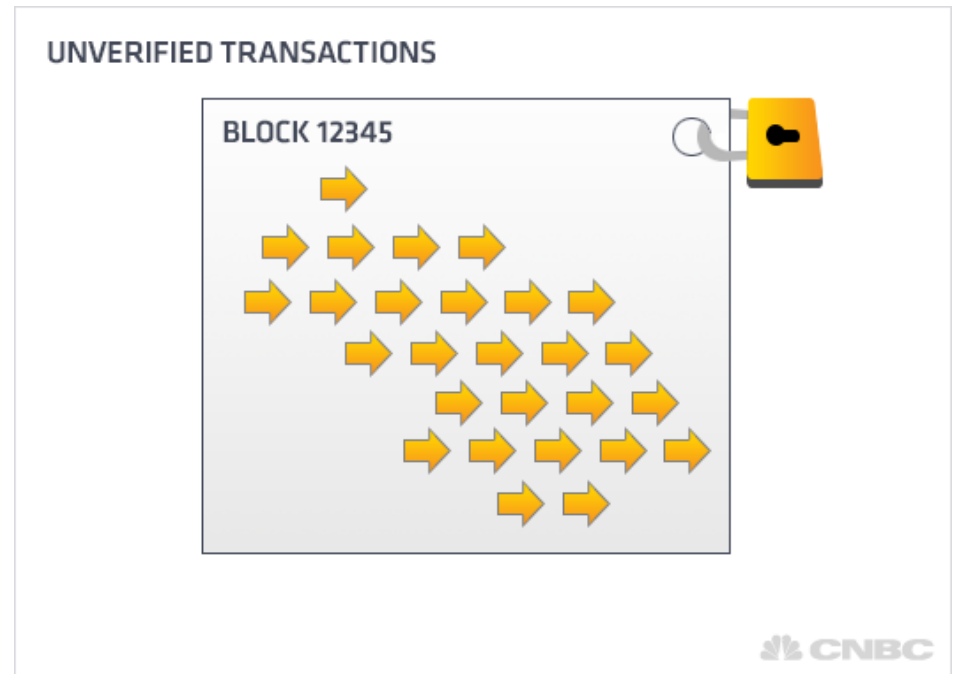
With Bitcoin, “miners” use special software to solve math problems and are issued a certain number of bitcoins in exchange. All the transactions are gathered in a type of ledger called the “blockchain.”



# Acquiring Bitcoin

## 3. Mining Bitcoin

- The bitcoin network self-regulates and self-accounts by collecting all of the bitcoin transactions made during a set period into a list, called a block.
- Miners confirm those transactions, and write them into the general ledger (the blockchain). In exchange the miner receives bitcoins.



# Mining Bitcoin



# Bitcoin Takes Off

Cyprus bank seizure in spring of 2013

1/5/13: \$13.36 → 11/29/13: \$1,124.76



# Bitcoin Drops Off

## Regulators Step In

March 2013: FinCEN issues guidelines on cryptocurrency exchangers and certain transactions.

May 2013: In May 2013, the Dept of Homeland Security seizes assets belonging to the Mt. Gox exchange.

October 2013: US Gov't seizes the dark web marketplace known as "Silk Road" and \$50 million worth of bitcoin. Bitcoin gets a reputation as a central pillar in black market internet transactions.

# Bitcoin Drops Off

## Hacking Issues; Mt. Gox

November 2013: An estimated \$100 million in bitcoins were stolen from the online illicit goods marketplace Sheep Marketplace, which immediately closed.

February 2014: Mt. Gox, then the largest bitcoin exchange, reveals the “loss” of 850,000 bitcoins, with a value at the time of approximately \$473 million. By the end of the February, bitcoin price falls to near \$560, periodically dipping into the \$400s.



# Bitcoin Stabilizes??

## Coinbase

January 2015:

- Coinbase, Inc., a startup out of San Francisco, announces \$75 million funding.
- Backers include the New York Stock Exchange, BBVA, USAA, and former Citigroup CEO Vikram Pandit.



# Regulatory Issues

## Scale of Bitcoin Use

- In 2014, bitcoin daily transaction volume fluctuated from 40,000-80,000 transactions per day. By contrast, Visa card transactions were approximately **24 million** per day.
- Congress and the Federal Reserve are still in the exploratory stage.
- Certain regulatory institutions have taken note and provided guidance.

# Regulatory Issues

## FinCEN Regulation

- Department of Treasury's Financial Crimes Enforcement Network issues anti-money laundering guidance in March 2013.

If a person is:

- engaged in business of exchanging cryptocurrencies, OR
- engaged in business of issuing a cryptocurrency with authority to withdraw such currency from circulation

THEN

- such person is deemed a Money Services Business, AND
- will be required to register as a Money Transmitter.

# Regulatory Issues

## FinCEN Regulation

- As a Money Services Business (MSB) and Money Transmitter, such person must have an effective AML compliance program which includes the four pillars:
  - Internal Procedures and Controls (customer data)
  - AML Compliance Officer
  - Training
  - Independent Testing
- Note: A user of virtual currency “is not an MSB under FinCEN's regulations and therefore is not subject to MSB registration, reporting, and recordkeeping regulations.”

# Regulatory Issues

## State Regulation

- Money Transmitters generally must be licensed in each state in which they operate
- Minimum net worth requirements
  - Cryptocurrency is the inventory.
  - Minimum dollars on hand at all times?
- Access to Capital, Banking Services
- 18 U.S.C. § 1960 – Criminal penalties for unlicensed Money Transmitters

# Regulatory Issues

## IRS and Tax Issues

- IRS Notice 2014-21
  - Bitcoin is not currency.
  - Taxed as property.
  - Taxpayers need to know the basis in order to compute gain or loss.
  - IRS takes the position that the value of virtual currencies must be reported in USD and the fair market value is determined on the date of payment or receipt.

# Regulatory Issues

## IRS and Tax Issues

- You purchase a \$2 cup of coffee with bitcoin bought for \$1. What tax liabilities would be triggered?
  - \$1 in capital gains for the coffee drinker
  - \$2 of gross income for the coffee shop

# Regulatory Issues

## IRS and Tax Issues

- IRS Notice 2014-21
  - Bitcoin mining is a taxable event.
  - “[W]hen a taxpayer successfully ‘mines’ virtual currency, the fair market value of the virtual currency as of the date of receipt is includible in gross income.”
  - Takeaway: Miners are performing a service and are being paid in bitcoin.
  - Compare income taxation of gold miners.



# Regulatory Issues

## Securities and Exchange Commission

- Dec. 8, 2014: The Securities and Exchange Commission sanctioned a computer programmer for operating two online venues that traded securities using bitcoin and litecoin without registering the venues as broker-dealers or stock exchanges.
- These exchanges provided account holders the ability to use bitcoin or litecoin to buy, sell, and trade securities of businesses (primarily virtual currency-related entities) listed on the exchanges' websites.
- SEC Digital Currencies Working Group and others conducted the investigation.

# Regulatory Issues

## Commodity Futures Trading Commission

- CFTC has authority to regulate commodities futures and their markets, and certain foreign exchange instruments.
- No significant regulation to date.
- It is possible CFTC could include cryptocurrency in “commodity,” which is defined as “all other goods and articles.”
- Could include cryptocurrency in “foreign exchange,” which is undefined.