ML Strategies Legislative Update

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Bitcoin: Regulators and States Out Ahead—Will Congress Follow?

Bitcoin, a decentralized digital currency that facilitates quick exchanges of value, has received steady attention from the media and industry stakeholders. Akin to gold, bitcoins are mined using computers to solve increasingly complex equations and can also be bought on exchanges and transferred directly as a means of payment. As a digital and virtual currency, Bitcoin value is not currently tied to an existing currency standard or regulated by a single entity. Bitcoin has been plagued by controversy—ranging from skepticism over the actual value of a wholly virtual currency, to legal concerns following the shutdown of the Silk Road black market, to the mystery of the hacked and stolen bitcoins from the Mt. Gox exchange. With Bitcoin likely here to stay, federal regulators and states have begun devising schemes under which they can be exchanged and spent safely and securely—but will Congress follow their lead?

Congress Taking Increased Notice

The Senate Homeland Security and Government Affairs Committee (HSGAC), led by Chairman Tom Carper (D-DE), has been out front on the issue—holding a hearing in November on the potential promise and threats of virtual currency, and facilitating a report by the Law Library of Congress on treatment and regulation of bitcoins in select international banking jurisdictions. The Senate Banking, Housing, and Urban Affairs Committee also held a joint subcommittee hearing, mainly focused on how regulators are interacting with virtual currencies to mitigate risk and illicit activity.

In the coming months, expect to see HSGAC continue its investigation into Bitcoin. The Committee has requested that the Government Accountability Office (GAO) study bitcoins and produce a report, which is expected to be published in late spring. The Committee also played a role in pushing the Internal Revenue Service (IRS) to release last week's guidance, discussed further below, and continues to work with other agencies, including the Federal Elections Commission (FEC) on devising appropriate regulation of bitcoins.

In addition, on April 2nd, the House Small Business Committee will hold the first House-side hearing on Bitcoin. The hearing, "Bitcoin: Examining the Benefits and Risks for Small Business," is intended to be educational for Members and for the small business community who may be considering accepting bitcoins as payment. While the Committee's jurisdiction in this area is limited, and legislation is unlikely to result, depending on the outcome of the testimony, the Committee may consider a letter to regulators summarizing views shared in the hearing and requesting regulators carefully consider small business in any future virtual currency regulation.

Agencies and States Taking the Lead

With Congress remaining relatively quiet on Bitcoin, federal agencies and states have gotten out ahead on the issue. Most notably on March 25th, the IRS issued guidance on the tax implications of virtual currency, including Bitcoin. The guidance established that bitcoins will be treated as property rather than currency for tax purposes, meaning, as with stock, bonds, and real estate, Bitcoin holdings will be subject to a capital gains tax. In addition, in 2013, the Financial Crimes Enforcement Network (FinCEN) issued interpretive guidance on the application of the Bank Secrecy Act (BSA) to those "creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies." FinCEN has since qualified this guidance in a January 2014 release to state that miners of a virtual currency for their own purposes and companies purchasing and selling virtual currencies for their own purposes are not considered money transmitters under the BSA. Notably, based on recent comments by Treasury Undersecretary for Terrorism and Financial Intelligence David Cohen, FinCEN and the Treasury could be poised for additional action. Cohen announced that for the first time a representative from the digital currency industry will be represented on the Bank Secrecy Act Advisory Group and said that the Treasury will pursue smart regulation that fosters innovation while ensuring transparency.

In the Senate Banking Committee's hearing on the Federal Reserve's (Fed) semiannual report to Congress, Chairwoman Janet Yellen noted in her testimony that the Fed "simply does not have authority to supervise or regulate Bitcoin in any way" and that Bitcoin is "a payment innovation that is taking place entirely outside the banking industry and to the best of my knowledge there is no intersection at all." Meanwhile, the Commodity Futures Trading Commission (CFTC) has said it is exploring its jurisdiction over Bitcoin. While the agency has yet to determine its role in regulating the virtual currency, should it decide that bitcoins should be regulated as a commodity or should offshoot products develop—such as a potential Bitcoin derivatives market—the CFTC's role would become clearer. Even if the CFTC were to deem that Bitcoin would be regulated as a commodity by the agency, the Securities and Exchange Commission (SEC) could also find it appropriate to regulate bitcoins as a security. The SEC has already pursued enforcement action in this space, cracking down on a Ponzi scheme run around a Bitcoin trust.

As federal regulators feel out jurisdiction, states—namely New York—have begun to proceed. In January, the New York City Economic Development Corporation held a two day long series of hearings convened by New York State Department of Financial Services. As a result of these hearings, the Department of Financial Services announced plans to institute enhanced consumer disclosure requirements, stronger capital requirements, and require companies to obtain a "BitLicense."

While New York is out front, other states have also begun to consider the issue of Bitcoin. California is considering legislation that would allow for the use of "alternative currency" to be redeemable as lawful U.S. tender; Illinois' legislature has introduced a bill to define virtual currency as "a medium of exchange that operates like currency in some environments, but does not have all the attributes of real currency;" and the Conference of State Bank Supervisors announced the formation of an Emerging Payments Task Force to study virtual currencies and possible regulation. Still other states have issued consumer alerts cautioning against Bitcoin risks, such as volatility, tax implications, and connection to criminal activity.

Virtual Versus Mobile

As policymakers and regulators grapple with the complex issues surrounding Bitcoin, it is important to define the conversation. Although bitcoins can be used to purchase goods and services at select retailers through a third party payment processor that immediately converts a bitcoin payment to US dollars for payment to the merchant, this transaction is not tantamount to a conventional mobile payment. Many third party mobile payment processors exist and are increasingly used by consumers for both point of sale and online purchases. These traditional mobile payments are subject to a myriad of existing financial services, banking, and consumer protection regulations. Among the many policy considerations Congress and regulators will be faced with should they pursue Bitcoin more aggressively will be how to separate conventional mobile payments from being caught up in potential burdensome regulation of emerging virtual currencies and third party transfer vendors.

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