



## CRYPTOCURRENCY MONEY TRANSMITTER ADVISORY MEMO

FEBRUARY 25, 2016

### GENERAL BACKGROUND & RISK TO THE BARTER INDUSTRY

The recent growth in popularity of Bitcoin and similar cryptocurrencies, (also known as altcoins), has caused confusion and fear though all sectors of the barter industry, be it retail barter exchanges, corporate barter companies, complementary currency systems or countertrade organizations.

Recent "guidance" directives from the IRS and the US Treasury Department's Financial Crimes Enforcement Network (FinCEN) have seemingly blurred the distinctions between cryptocurrencies and barter/trade credits even further. Meanwhile numerous states in the US, (and countries internationally), are re-writing their financial regulations in an attempt to regulate the transmission of Bitcoin-like cryptocurrencies by imposing expensive registration and capital deposit requirements. While the initial noble intent of such regulatory re-examination was/is to prevent financial crimes and protect consumers, the overt risk is that the new financial language will be so broad that it will inadvertently include barter business models in the definition of money transmitters, which we believe would be inaccurate.

The financial/banking sector's fear and confusion about cryptocurrencies is causing adverse effects to the barter industry. Barter exchanges have recently been denied cash credit lines from banks due to the banks' misperception that barter exchanges are money transmitters. Additionally, numerous credit card processing companies have decided not to accept applications from barter exchanges because they too have erroneously concluded that barter exchanges are money transmitters. We know of one instance where a bank terminated its relationship with a barter company after decades of doing business with the exchange.

In the past two years IRTA has successfully argued that barter/trade credits are not cryptocurrencies and therefore are not money transmitters and should not be subject to new regulations designed to reign-in cryptocurrencies. IRTA received a favorable opinion from the California Department of Business Oversight on June 26<sup>th</sup>, 2014 that defines the key elements that separates trade credits and the barter industry from the cryptocurrency world, (attached as Addendum "A").

This IRTA Advisory Memo will explain the important cryptocurrency/trade credit distinctions that are articulated in the model California Opinion and thereby serve as a tool for the barter industry to educate the financial/banking sector and business sectors so as to prevent adverse policy decisions that negatively affect the barter industry.

**NOTE: DEFINITIONAL CLARIFICATION:** The term "digital currency" and "virtual currency" for purposes of this memo are interchangeable. Cryptocurrencies are decentralized digital/virtual currencies that implement principles of cryptography technology, built on blockchain applications that operate to validate transactions and generate the currency itself. The blockchain provides a proof-of-work system to guard against digital counterfeiting.

**NOTE: EVOLVING SECTOR:** The cryptocurrency/money transmitter regulatory environment is constantly evolving. As such, IRTA will review and update this Advisory Memo as needed, and new revisions of this memo will be released accordingly in the future.

## MONEY TRANSMITTER REGULATORY HISTORY - FINCEN

The US Federal government has regulated money transmission since 1970 via the Bank Secrecy Act (BSA). BSA related matters are administered by a bureau within the Financial Crimes Enforcement Network, (FinCEN). The BSA was passed to prevent money laundering and mandates that money service businesses (MSB's) report and record various financial transactions. FinCEN regulations require MSB's to register with FinCEN, report transactions to FinCEN and to adopt procedures that prevent money laundering. Several amendments to the BSA have occurred over the years; for example, the requirement from the 2001 Patriots Act that required financial companies to report all cash transactions exceeding \$10,000.

In March of 2013 FinCEN issued new guidance to clarify the applicability of the BSA regarding persons/entities that are "creating, obtaining, distributing exchanging accepting or transmitting virtual currencies." The FinCEN guidelines further stated that persons/entities that obtain virtual currencies to purchase goods or services do not fit into the regulatory definition of a money transmitter. However, FinCEN went on to say that if the person/entity engaged in "the exchange of virtual currency for real currency" (ie the virtual currency is redeemable for cash), the person/entity would be considered a money transmitter.

IRTA's research of the March 2013 FinCEN guidelines concluded that unless the barter organization itself is trading or redeeming trade dollars for real cash, the organization would not fall under this new expanded guidance.

FinCen's focus via the BSA is on persons/entities that are moving currency under the radar. If a barter organization participates in the conversion of its currency to cash and back, such organizations could be considered money transmitters and subject to the BSA and/or state regulations. We are not aware of any barter retail organization that readily convert, or have a defined mechanism to convert barter/trade credits to cash.

### IRS 2014 GUIDELINES

On March 25<sup>th</sup>, 2014 the IRS provided a notice, definitions and answers to sixteen frequently asked questions regarding virtual currency, (see attached Addendum "B" – IRS 3/25/14 Notice & IRS Notice 2014-21).

The IRS's notice defined virtual currency by stating that "virtual currency 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 jurisdiction."

Most importantly, the IRS notices said that "virtual currency is treated as property for US federal tax purposes may be used to pay for goods and services or held for investment." Further, the IRS stated that virtual currency "that has an equivalent value in real currency, or acts as a substitute for real currency is referred to as convertible virtual currency. Bitcoin is an example of a convertible virtual currency." Barter exchanges' barter/trade credits are not readily convertible to cash and barter exchanges do not have any mechanism to accomplish such a conversion.

### STATE REVIEW OF FINANCIAL REGULATIONS AIMED AT BITCOIN-LIKE CRYPTOCURRENCIES & IRTA REPOSSES

While the federal government has weighed-in on defining virtual currency/cryptocurrency and money transmission, many states in the U.S. are also examining their old financial regulations and re-writing them in an effort to regulate the ever growing cryptocurrency sector. The new name for these regulatory state initiatives designed to reign-in cryptocurrencies is "Bitlicenses."

The California Department of Business Oversight's, (CDBO), June 26, 2014 opinion letter, (attached as Addendum "A") arguably provides important precedent and definitional criteria that provide the basis for IRTA's position that barter/trade credits are not cryptocurrencies and barter exchanges are not money transmitters.

IRTA pointed-out in its April 25<sup>th</sup>, 2014 letter, (attached as Addendum "C"), to the CDBO that barter exchanges are not money transmitters and therefore are not subject to California's proposed new Money Transmission Act, (MTA). IRTA's key points were:

- Barter exchanges comply with TEFRA based IRS 1099B reporting requirements.

- Barter exchange trade credits denote a trade exchange members' right to receive, or obligation to pay in the network. Such member rights are between the members and the exchange serves as an arms-length third-party record keeper.
- The barter exchange does not hold collateral or guarantee trades between members.
- Barter/trade credits are not redeemable for cash.
- Barter exchange member agreements specifically state that trade credit are not legal tender.
- Barter/trade credits do not have stored value, do not earn interest and are not securities.
- Barter exchanges do not take possession of money for transmission.

The CDBO's June 26<sup>th</sup>, 2014 favorable opinion agreed with IRTA's arguments by stating that:

- Barter exchanges are third-party "record keepers of trade credits" and do not "receive money for transmission as defined by CA Financial Code Section 2003(s)."
- Barter exchanges "do not meet the definition of issuer of stored value." CA Financial code Section 2003(v) defines "stored value" as to mean "a monetary value representing a claim against the issuer that is stored on an electronic or digital medium." The issuer of stored values is the "entity that is liable to the holder of the stored value and has undertaken or is obligated to pay the stored value." Because "a barter exchange is not liable to the members for the value of their trade credits and it has not undertaken nor or is it obligated to pay the trade credits, a barter exchange is therefore not an issuer of stored value."
- Due to the above, "trade credits do not meet the definition of stored value."
- "Therefore, commercial barter exchanges do not need to be licensed under the MTA."

IRTA and legal counsel for National Commerce Exchange, (NCE), submitted a joint opinion letter to the New York State Department of Financial Services (NYDFS) on October 16<sup>th</sup>, 2014 which made several important additional arguments that distinguished barter exchange activity from money transmitter transactions, they were:

- Barter exchange transactions are not anonymous like cryptocurrency transactions. In fact barter exchanges report annually to the IRS all their members' names, addresses, and tax identification numbers who conducted barter transactions, pursuant to 1099B reporting requirements of TEFRA.
- Trade credits are not a digital or virtual currency based on the language of the proposed New York Code 23 NYDFS 200.1 (m) which defines virtual currency as "any type of digital currency unit that is used as a medium of exchange or a form of digital stored value...incorporated into a payment system technology." The CDBO's opinion arguably provides state opinion precedent that trade exchanges do not participate in issuing virtual currency with stored value.
- Barter/trade credits are merely an accounting unit, no cryptography technology is involved.
- Barter exchange trade credit systems do not involve "mining" (the sophisticated computer algorithm cryptography methodology that provides the proof-of-work cryptocurrency functionality).
- The value of trade exchange members' goods and services are valued and accounted for in U.S. dollars.

While the IRTA/NCE NYDFS letter specifically requested the NYDFS to exclude barter exchanges from their proposed virtual currency definition, the final NYDFS Rules that were released in June of 2015 contained a narrow definition of virtual currencies that included the component of a "stored value." Based on the California opinion, IRTA is satisfied that barter exchanges do not meet the definitional criteria for virtual currencies in the new NYDFS Code and thereby are not subject to the registration requirements contained therein.

## INTERNATIONAL APPROACHES TO VIRTUAL CRYPTOCURRENCIES

The European approach to the money transmitter cryptocurrency regulation has taken a much more unified approach as opposed to the U.S.'s somewhat fragmented federal vs. state approach.

The European Banking Authority (EBA) has spent the last three years reviewing the risks and rewards of a regulatory reform regarding cryptocurrencies and released several comprehensive reports outlined various regulatory scenarios that may be applicable, (see their most recent report titled "Cryptotechnologies, A Major IT Innovation & Catalyst For Change" at:

[https://www.abe-eba.eu/downloads/knowledge-and-research/EBA\\_20150511\\_EBA\\_Cryptotechnologies\\_a\\_major\\_IT\\_innovation\\_v1\\_0.pdf](https://www.abe-eba.eu/downloads/knowledge-and-research/EBA_20150511_EBA_Cryptotechnologies_a_major_IT_innovation_v1_0.pdf)

The EBA has called for government and businesses to come together to develop regulatory solutions for the cryptocurrency sector which effectively requires a "digital revamping" of the European banking system.

The European Union's, (EU), highest court, The European Court of Justice, (ECJ), did render a decision on October 22, 2015 stating that Bitcoin transactions "are exempt from Value Added Tax, (VAT), under the provision concerning transactions relating to currency, bank notes and coins used in legal tender." The decision thereby operates to treat virtual currencies in the same way as traditional cash, (see attached Addendum "D" for the full ECJ opinion).

The EU Commission is also expected to address the anonymity component of cryptocurrencies when it releases its 4th Anti-Money Laundering Directive (4AML) the second quarter of 2016.

## REVIEW OF KEY CRITERIA THAT SEPARATES THE BARTER INDUSTRY FROM CRYPTOCURRENCIES/MONEY TRANSMITTERS

When presented with the question of whether the barter industry engages in cryptocurrency and/or money transmission activities, the key delineating points are:

- Barter exchanges in the U.S. already comply with the legal mandates of TEFRA by providing 1099B reporting of all barter transactions, including the names, addresses and tax identification numbers of their members that made barter sales. Hence, barter exchange transactions between members are not anonymous.
- Barter/trade credits are simply a unit of accounting. Trade credits denote a trade exchange members' right to receive, or obligation to pay in the network. Such member rights are between the members and the exchange serves as an arms-length third-party record keeper.
- No cryptography methodologies are present with barter trade credits.
- Barter exchange does not hold collateral or guarantee trades between members.
- Trade credits are not redeemable or convertible for cash.
- Barter trade credits do not have stored value, do not earn interest and are not securities.
- As third party record keepers, barter exchanges do not take possession of money for transmission.
- Barter exchange trade credit systems do not involve "mining" (the sophisticated computer algorithm cryptography methodology that provides the proof-of-work cryptocurrency functionality).
- The value of trade exchange members' goods and services are valued and accounted for in U.S. dollars.

As stated earlier, due to the ongoing evolutionary nature of the cryptocurrencies and money transmitter regulations, IRTA will review and update this memo as needed.

Please review the IRTA website at [www.irta.com](http://www.irta.com) regularly for recent updates and revisions to this advisory memo.

**ADDENDUM A**

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<http://www.irta.com/wp-content/uploads/2016/01/California-Dept-Business-Oversight-Letter-to-IRTA-2014-06-26.pdf>

**ADDENDUM B**

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<https://www.irs.gov/uac/Newsroom/IRS-Virtual-Currency-Guidance>

AND

[https://www.irs.gov/irb/2014-16\\_IRB/ar12.html](https://www.irs.gov/irb/2014-16_IRB/ar12.html)

**ADDENDUM C**

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<http://www.irta.com/wp-content/uploads/2016/01/IRTA-Letter-to-California-Dept-Business-Oversight-2014-04-25.pdf>

**ADDENDUM D**

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<http://curia.europa.eu/juris/document/document.jsf?text=&docid=170305&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=604646>