

October 15, 2019

Federal Agencies Issue Joint Statement on AML/CFT Obligations, and IRS Updates Guidance, for Digital Assets

Last week, multiple federal agencies issued guidance for individuals who own digital assets or operate services involving them. The U.S. Commodity Futures Trading Commission (“CFTC”), the U.S. Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”), and the U.S. Securities and Exchange Commission (“SEC”) issued a joint statement “reminding” those engaged in activities involving digital assets of their anti-money laundering (“AML”) and countering the financing of terrorism (“CFT”) obligations under the Bank Secrecy Act (“BSA”). The Internal Revenue Service (“IRS”) also updated its guidance on tax responsibilities for virtual currency.

October 11, 2019 Joint Statement by CFTC, FinCEN, and SEC

The heads of the CFTC, FinCEN, and the SEC issued a joint statement to “remind” companies and individuals engaged in activities involving various forms of digital assets, including cryptocurrency, that they must comply with the BSA’s AML/CFT obligations.¹ Acknowledging that market participants may refer to the same asset or service in different ways, the agencies said they will look past “label or terminology” to the “facts and circumstances underlying an asset, activity or service” to determine the applicability of federal registration requirements and any AML/CFT obligations.² The statement further clarified that certain BSA obligations—including developing a BSA/AML program or reporting suspicious activity—apply “very broadly and without regard” to the determination of whether the asset, service or activity involves a security or a commodity.³ The agencies will look to the “nature of the digital asset-related activity a person engages in” when determining whether and how a company or individual must register with their respective agencies.⁴

Each agency provided additional comments reflecting its specific concerns:

- **CFTC:** The CFTC issued a reminder to introducing brokers and futures commission merchants registered under the Commodities Exchange Act (“CEA”) that they are required to report suspicious activity and to implement a reasonably-designed BSA/AML program in the digital asset context. Such requirements are not limited to activities in which the digital assets qualify as commodities or are used as derivatives, but also apply to digital asset-related activities that are not subject to regulation under the CEA.
- **SEC:** The SEC reminded broker-dealers and mutual funds of the “similar or additional”⁵ AML/CFT risks of engaging in transactions involving digital assets, as opposed to transactions in cash and cash

equivalents. It further advised that the requirements to implement a reasonably-designed BSA/AML program and to report suspicious activity are not limited to activities involving digital assets that qualify as “securities” under the federal securities laws.

- **FinCEN:** Referencing FinCEN’s May 2019 interpretive guidance⁶ on which digital asset-related activities qualify an entity as a FinCEN-regulated money services business (“MSB”), FinCEN clarified that “any person ‘registered with, and functionally regulated or examined by, the SEC or the CFTC,’ would not be subject to the BSA obligations applicable to MSBs, but instead it would be subject to the BSA obligations of such a type of regulated entity.”⁷

IRS Updated Guidance on Virtual Currency Tax Responsibilities

The IRS’s new guidance related to transactions involving virtual currency focuses on the tax treatment of a cryptocurrency “hard fork.” The accompanying FAQs expand on those previously-released in Notice 2014-21, and address topics including basis, gain or loss on the sale of exchange of the currency, and how to determine fair market value in a manner generally consistent with treating virtual currencies as property included in a barter transaction, not as “currencies.” The Revenue Ruling can be found in Revenue Ruling 2019-24⁸ and the FAQs⁹ can be found on the IRS’s website. In addition to this guidance, on October 11th, the IRS released an amendment to the 2019 individual tax return¹⁰ (Form 1040) that, if finalized, may have wide-reaching enforcement implications.

Revenue Ruling 2019-24: “Hard Forks” and “Airdrops”

Revenue Ruling 2019-24 deals specifically with two issues: (1) whether a taxpayer has gross income under § 61 as a result of a so-called “hard fork” of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency following the hard fork, and (2) whether a taxpayer has gross income as a result of an “airdrop” of a new cryptocurrency following a hard fork if the taxpayer receives units of a new cryptocurrency.

The Revenue Ruling explains that a hard fork “is unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger.”¹¹ The IRS further notes that “[a] hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger.”¹² The Revenue Ruling describes an airdrop as “a means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple taxpayers.”¹³ The IRS adds that “[a] hard fork followed by an airdrop results in the distribution of units of the new cryptocurrency to addresses containing the legacy cryptocurrency.”¹⁴

Following general principles¹⁵ that “all gains or undeniable accessions to wealth . . . over which a taxpayer has complete dominion” are gross income, the Revenue Ruling concludes that taxpayers do not have gross

income as a result of a hard fork if the taxpayer does not receive units of a new cryptocurrency, but do have gross income if they receive units of the new currency as the result of an airdrop following a hard fork. The distinction is based on the receipt of the cryptocurrency that is capable of being valued and traded. In the case of the hard fork without the taxpayer's receipt of additional virtual currency, the taxpayer does not have any accession to wealth or gross income. But, in the case of the airdrop following the hard fork, the taxpayer receives an asset of arguable value, over which it exercises "dominion and control," and which it is immediately able to transfer. As a result, in the latter case, the taxpayer has gross income equal to the value of the new virtual currency it receives in the airdrop.

FAQs

The FAQs clarify and expand on prior guidance in Notice 2014-21, generally treating virtual currency as property instead of currency for tax purposes, and treating transactions in that property as similar to barter transactions, *e.g.*, a taxpayer's exchange of virtual currency for goods and services (including cash) is generally a taxable transaction. There is nothing ground-breaking in these FAQs; they generally cover nearly all common transactions that could occur in virtual currency in simple, understandable language and generally make tax payment and tax reporting obligations related to virtual currency clear.

Draft 2019 Individual Tax Form – Change re Virtual Currency

In addition to the above, on October 11th, the IRS released a draft tax form that includes the following "yes" or "no" question: "At any time during 2019, did you receive, sell, send, exchange or otherwise acquire any financial interest in any virtual currency?"¹⁶ This question is similar to the "yes" or "no" question that was added several years ago related to a U.S. taxpayer's control over a foreign account, which the IRS used as an enforcement tool in pursuing taxpayers who did not report income from foreign accounts. This new question is likely intended as a further enforcement mechanism helping the IRS bridge the compliance gap with respect to virtual currency.¹⁷ A taxpayer who answers untruthfully may have committed perjury and could be subject to civil and criminal liability for lying on a tax form. This will give the IRS a "stick" in pursuing taxpayers engaging in virtual currency transactions, but not appropriately reporting these transactions.

Practical Takeaway

The announcements from the CFTC, FinCEN, the SEC and the IRS last week signal that these agencies are continuing to focus on enforcing BSA/AML and tax laws relating to digital assets even while the regulatory landscape relating to these assets, including cryptocurrencies, is developing. We will continue to monitor the efforts to regulate the digital asset space, and the enforcement actions that are likely to follow based on existing and newly developed laws and regulations.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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¹ Leaders of CFTC, FinCEN, and SEC Issue Joint Statement on Activities Involving Digital Assets (Oct. 11, 2019), available [here](#).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ FinCEN, *Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies* (May 9, 2019), available [here](#).

⁷ Leaders of CFTC, FinCEN, and SEC Issue Joint Statement on Activities Involving Digital Assets (Oct. 11, 2019), available [here](#).

⁸ Rev. Rul. 2019-24, available [here](#).

⁹ IRS, *Frequently Asked Questions on Virtual Currency Transactions* (last updated Oct. 9, 2019), available [here](#).

¹⁰ IRS, *Draft Release, 2019 Form 1040, Schedule 1, Additional Income and Adjustments to Income* (last updated Oct. 11, 2019), available [here](#).

¹¹ Rev. Rul. 2019-24, available [here](#).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ See I.R.C. § 61 (2012); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). Both were discussed in Revenue Ruling 2019-24.

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- ¹⁶ IRS, *Draft Release, 2019 Form 1040, Schedule 1, Additional Income and Adjustments to Income* (last updated Oct. 11, 2019), available [here](#).
- ¹⁷ See, e.g., *IRS Collections Has the Coinbase John Doe Summons Names*, TAXNOTES (Oct. 29, 2018), available [here](#).