XIII.   Bitcoin and Money Laundering

A.   Introduction

Satoshi Nakamoto presented Bitcoin for the first time in 2009 in an essay titled "Bitcoin: A Peer-to-Peer Electronic Cash System," and it has since quickly risen to the most popular, decentralized virtual currency in the world.[1] Bitcoin is "a new payment system" of digital money used on a "decentralized peer-to-peer payment network that is powered by its users with no central authority or middlemen."[2] Bitcoin's current total market cap as of November 30, 2016 is $11.85 billion and Bitcoin has attracted the attention of both small and large businesses as well as individuals and consumers around the globe.[3] As Bitcoin continues to undergo rapid development and is projected to make a big impact on society and the global economy, regulators, such as the Internal Revenue Service (IRS) and the Commodity Futures Trading Commission (CFTC), have started to pay attention to its anonymous nature.[4] For example, Bitcoin is a decentralized currency that is very different than any traditional types of currency presently regulated under both federal and state laws.[5] While there are many advantages of a decentralized payment system, recent years have demonstrated that Bitcoin has played a part in illegal criminal activities, such as money laundering.[6] As recent case law shows, deciding how to regulate Bitcoin within the greater regulatory scheme

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[1] Kavid Singh, *The New Wild West: Preventing Money Laundering in the Bitcoin Network*, 13 NW. J. TECH. & INTELL. PROP. 37, 37–38 (2015). *See generally* Satoshi Nakamoto, *A Peer-to-Peer Electronic Cash System*, BITCOIN PROJECT (2009), https://Bitcoin.org/Bitcoin.pdf [https://perma.cc/4ALF-HTXY].

[2] *Frequently Asked Questions*, BITCOIN PROJECT (2016), https://Bitcoin.org/en/faq#what-is-Bitcoin [https://perma.cc/A9F4-FYYV].

[3] *Bitcoin Price Index Chart,* COINDESK (Nov. 30, 2016), http://www.coindesk.com/price/ [https://perma.cc/X3U3-SHXN].

[4] Stan Higgins, *US Central Bank Chair: Blockchain Could Have 'Significant' Impact*, COINDESK (Sept. 28, 2016), http://www.coindesk.com/us-fed-yellen-blockchain-impact/ [https://perma.cc/7AKD-4NW7].

[5] *See* Jacob Bogage, *Bitcoin's Not Money, Judge Rules As She Tosses Money-Laundering Charge*, WASH. POST (July 26, 2016), https://www.washingtonpost.com/news/morning-mix/wp/2016/07/26/Bitcoins-not-money-judge-rules-as-she-tosses-money-laundering-charge/ [https://perma.cc/3XBW-V677].

[6] Singh, *supra* note 1, at 37.

of currency and anti-money laundering regulation is tough.[7] Lawmakers must strike a balance between hindering criminal activity and maintaining Bitcoin's potential growth and increased advancement.[8]

This article focuses on Bitcoin in the context of money laundering over the past few years and discusses previous and future regulatory action within the virtual currency arena. First, Section B gives a brief history of Bitcoin and its development, and discusses the advantages and disadvantages of a virtual payment system. Section C demonstrates the mismatch of opinions throughout the legal system about how to define Bitcoin when it is being used in criminal activities, especially in money laundering. Section D explains previous regulatory actions that have been taken in the past to try to clarify what Bitcoin should be defined as. Finally, Section E looks to the future of regulation of Bitcoin and other virtual currencies, including the challenges that regulators and lawmakers will face as they decide the best way to deal with Bitcoin on both a state and federal level.

B.   Brief History of Bitcoin and Recent Developments

Bitcoin has quickly risen to the status of "the most popular, decentralized form of virtual currency in the world."[9] The rise of Bitcoin came along with the ongoing "trend of digitizing transfers of money" for which many financial technology companies strive.[10] The biggest advantage of Bitcoin is the avoidance of the "double-spending" problem, which is "the risk that a person could concurrently

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[7] *See generally* United States v. Faiella, 39 F. Supp. 3d 544 (S.D.N.Y. 2014); United States v. Ulbricht, 31 F. Supp. 3d 540 (S.D.N.Y. 2014); Jacob Gershman, *Federal Judge: Yes, Bitcoins Are Money*, WALL ST. J.: LAW BLOG (Sept. 20, 2016, 2:04 PM), http://blogs.wsj.com/law/2016/09/20/federal-judge-yes-Bitcoins-are-money/ [https://perma.cc/G8KZ-AZKG]; Robert Hackett, *Bitcoin Is Not Money, Miami Judge Rules*, FORTUNE (July 25, 2016), http://fortune.com/2016/07/25/Bitcoin-money-laundering-miami-judge/ [https://perma.cc/75QG-TKWG].

[8] JERRY BRITO & ANDREA CASTILLO, BITCOIN: A PRIMER FOR POLICYMAKERS 7 (2d ed. 2016).

[9] Singh, *supra* note 1, at 37.

[10] Glen Williams & David Gunn, *What Big Banks Can Learn from Bitcoin's Technology*, FORBES (Sept. 9, 2016), http://www.forbes.com/sites/baininsights/2016/09/09/what-big-banks-can-learn-from-Bitcoins-technology/print/ [https://perma.cc/EJA3-ST3L].

send a single unit of currency to two different sources."[11] Many virtual currencies face the "double-spending" problem because of the ease of duplicating virtual currency already used in other transactions.[12] This can completely undermine the value of the underlying currency.[13] Bitcoin has a public ledger that records every transaction and every single Bitcoin used, thus making it impossible to double-spend the same Bitcoin.[14] Additionally, the Bitcoin network is a decentralized network, in which no one individual has complete ownership or control.[15] As such, Bitcoin transactions do not require middlemen services, such as PayPal, eliminating the otherwise time-consuming and costly process going through a third party to complete a transaction.[16] In addition, Bitcoin has helped to improve access to capital, lower transaction costs for small business, and provide avenues for financial innovation.[17] For example, international money transfers usually have to go through a third party, which pockets some of this money for itself, thus leaving the sender with less money than he or she intended to send.[18] Because there is no middleman, but instead a public ledger, one can send money globally without having to incur this additional fee of payment to the third party.[19]

However, these same qualities that make Bitcoin "an attractive payment system" have also paved the way for illegal activities, including money laundering.[20] Bitcoin's decentralized network means that users are "pseudonymous"—while every single Bitcoin

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[11] Erik Bonadonna, *Bitcoin and the Double-Spending Problem*, CORNELL U.: NETWORKS II (Mar. 29, 2013), https://blogs.cornell.edu/ info4220/2013/03/29/Bitcoin-and-the-double-spending-problem/ [https://perma.cc/AF97-7NK9].

[12] *Id.*

[13] Singh, *supra* note 1, at 40.

[14] BRITO & CASTILLO, *supra* note 8, at 7.

[15] *Frequently Asked Questions*, *supra* note 2.

[16] Williams & Gunn, *supra* note 10.

[17] Singh, *supra* note 1, at 37.

[18] Michael Beckerman, *The Benefits of Allowing Bitcoin to Flourish*, N.Y. TIMES: DEALBOOK (Sept. 21, 2015), http://www.nytimes.com/ 2015/09/22/business/dealbook/the-benefits-of-allowing-Bitcoin-to-flourish.html [https://perma.cc/6NB8-5L5T] (explaining that international money transfers "costs nearly 8 percent of the total amount sent to transfer money around the world, largely because of a complex web of third-party approvers").

[19] *Id.*

[20] BRITO & CASTILLO, *supra* note 8, at 2.

transaction is traceable on a public ledger, it is not tied to anyone's identity—thus making the Bitcoin system seriously attractive for criminal activity.[21] Users have found ways to gain access into Bitcoin exchanges to steal "hundreds of millions of dollars' worth of bitcoins" from businesses as well as use the virtual currency for online illegal drug markets.[22] For example, in August 2016, hackers stole about $65 million in Bitcoins from a Bitcoin exchange called Bitfinex, which ultimately sent the Bitcoin price down over 20 percent.[23] Additionally, the infamous Silk Road, which was shut down in 2014, was the ultimate black market that traded Bitcoins in exchange for illegal drugs, fake passports, driver's licenses, and illegal services, such as hiring a hit men and hackers.[24] The severity of criminal activity surrounding the use of this virtual currency has alerted regulators and lawmakers to focus their efforts in formulating an effective solution.[25] Such a solution would ideally eliminate Bitcoin's disadvantages and its susceptibility to criminal behavior and money laundering while preserving its otherwise advantageous payment system.[26]

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[21] *Id.*; Singh, *supra* note 1, at 42.

[22] Singh, *supra* note 1, at 37.

[23] Jethro Mullen, *Hackers Steal Bitcoins Worth Millions in Attack on Exchange*, CNN (Aug. 3, 2016), http://money.cnn.com/2016/08/03/ technology/Bitcoin-exchange-bitfinex-hacked/ [https://perma.cc/58CU-X3WG].

[24] Donna Leinwand Leger, *How FBI Brought Down Cyber-Underworld Site Silk Road*, USA TODAY (May 15, 2014), http://www.usatoday.com/ story/news/nation/2013/10/21/fbi-cracks-silk-road/2984921/ [https://perma.cc/PHH2-LKSZ].

[25] *See generally* U.S. COMMODITY FUTURES TRADING COMM'N, ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 6(C) AND 6(D) OF THE COMMODITY EXCHANGE ACT, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS, NO. 15-29, Sept. 17, 2015, http://www.cftc.gov/idc/groups/ public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder091 72015.pdf [https://perma.cc/BQK6-RBR9]; I.R.S. Notice IR-2014-36 (Mar. 25, 2014) [https://perma.cc/D6NT-PAWT]; FIN. CRIMES ENF'T NETWORK, U.S. DEP'T OF THE TREAS., FIN-2013-G001, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (2013); Adam Hayes, *Fla. Lawmaker Pushing to Classify Bitcoin as Money*, INVESTOPEDIA (Sept. 13, 2016), http://www.investopedia.com/news/fla-lawmaker-pushing-classify-Bitcoin-money/ [https://perma.cc/C2HC`-3DEQ].

[26] *See supra* note 8 and accompanying text.

C.   Bitcoin and Money Laundering

1.   Money Laundering Defined

Money laundering is defined as "the process of creating the appearance that large amounts of money obtained from serious crimes, such as drug trafficking or terrorist activity, originated from a legitimate source."[27] There are various precautions in place to avoid or identify money laundering via both state and federal laws.[28] Current federal money laundering regulation is guided by 18 U.S.C. §§ 1956–57, which makes it "illegal to conduct certain financial transactions with proceeds generated through specified unlawful activities, such as narcotics trafficking, Medicare fraud and embezzlement, among others."[29] Financial transactions are defined as "a transaction which in any way or degree affects interstate or foreign commerce . . . involving the movement of funds by wire or other means or . . . involving one or more monetary instruments."[30] Further, monetary instruments are defined as "coin or currency of the United States or of any other country."[31]

Additionally, regulation is in place to monitor money transmitters—businesses that transmit funds from one person to another—who transmit currency in excess of $10,000, usually across U.S. borders.[32] Any money transmitter business or service must obtain a license to operate and is subject to the Bank Secrecy Act (BSA), which includes "an obligation to maintain an anti-money laundering program, as well as registration, reporting and record-keeping requirements."[33] Additionally, it is illegal to operate an unregulated

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[27] *Money Laundering*, INVESTOPEDIA, http://www.investopedia.com/terms/ m/moneylaundering.asp?lgl=no-infinite [https://perma.cc/Z9KM-AUC7].

[28] *See Federal Statutes—Money Laundering*, INTERNAL REVENUE SERV. (Feb. 5, 2016), https://www.irs.gov/uac/federal-statutes-money-laundering [https:// perma.cc/F3AW-S6H6].

[29] *Id.*

[30] 18 U.S.C. § 1956(c)(4) (2012).

[31] § 1956(c)(5)

[32] BRITO & CASTILLO, *supra* note 8, at 43.

[33] Financial Recordkeeping and Reporting of Currency and Foreign Transactions (Bank Secrecy) Act of 1970, 31 U.S.C. § 5311 (2012); *FinCEN Issues Guidance on Application of Money Transmission Definitions and Exemption to Certain Business Models*, SIDLEY AUSTIN (May 1, 2014), http://www.sidley.com/news/fincen-issues-guidance-on-application-of-

and unlicensed money-transmission business under the Patriot Act and 18 U.S.C. § 1960, which states that anyone who conducts an unlicensed money transmitting business can be fined or subject to up to five years in prison.[34] Money transmitters are also subject to state licensing regulations, which requires a money transmitting business or service to register within the individual state as well.[35] In addition, money services businesses (MSB), which includes money transmitters, are required to file Suspicious Activity Reports (SARs), which requires an MSB to report a transaction "if the MSB knows, suspects or has reason to suspect that the transaction…involved funds derived from illegal activity … or is designed to evade the requirements of the Bank Secrecy Act."[36] These money transmitter regulations provide transparency of businesses transporting currency so as to create a "significant impediment to the use of illicit profits by narcotics and others engaged in illegal activities."[37]

2.   Previous Attempts to Categorize Bitcoin Within the Money Laundering Scheme

The biggest problem facing regulators with virtual currencies, such as Bitcoin, is whether virtual currencies fit within the definition of words such as "currency" or "funds" that are found in federal and state anti-money laundering statutes and the BSA. More specifically, courts have struggled with whether Bitcoin are going to be defined as currency for purposes of regulation and enforcement in criminal actions.[38]

In several landmark cases over the last few years, federal prosecutors were able to successfully send Bitcoin users to prison on, among other charges, money-laundering offenses.[39] Most notably, in *United States v. Ulbricht*, Ross Ulbricht, the criminal operator of the

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money-transmission-definitions-and-exemptions-to-certain-business-models-05-01-2014 [https://perma.cc/7J79-7FDV].

[34] 18 U.S.C. § 1960 (2012); BRITO & CASTILLO, *supra* note 8, at 44.

[35] *See id*. at 47.

[36] *Money Services Business (MSB) Suspicious Activity Reporting*, FINCEN, https://www.fincen.gov/money-services-business-msb-suspicious-activity-reporting [https://perma.cc/VU6R-AH2K].

[37] *Federal Statutes—Money Laundering*, *supra* note 28.

[38] *See generally* United States v. Faiella, 39 F. Supp. 3d 544 (2014); United States v. Ulbricht, 31 F. Supp. 3d 540 (2014).

[39] *See, e.g., Faiella*, 39 F. Supp. 3d 544; *Ulbricht*, 31 F. Supp. 3d 540.

infamous online drug market, Silk Road, was federally prosecuted on July 9, 2014 and sentenced to life in prison for money laundering, and other charges.[40] The Silk Road was designed as "an online marketplace for illicit goods and services" where buyers would purchase illegal drugs and malicious software in exchange for Bitcoins.[41] U.S. District Judge Katherine Forrest ruled that "funds," as stated in 18 U.S.C. § 1956(c)(4), includes anything that "can be used to pay for things" and since Bitcoins were traded for narcotics over Silk Road, "one can money launder using Bitcoin."[42] As stated by Judge Forrest, "Congress intended to prevent criminals from finding ways to wash the proceeds of criminal activity" and thus "the money laundering statute is broad enough to encompass use of Bitcoins in financial transactions."[43]

Similarly, in *United States v. Faiella* in 2014, Robert Faiella, a Bitcoin exchanger, and Charlie Shrem, CEO of a Bitcoin exchange, were both convicted for conspiracy to launder money and operation of an unlicensed money transmitter business by selling "over $1 million in Bitcoins to users of 'Silk Road.'"[44] In this case, U.S. District Judge Jed Rakoff stated that "bitcoin clearly qualifies as 'money' or 'funds'" after reading the dictionary definition of "money" as well as the text of 18 U.S.C. § 1960, the statute that prohibits unlicensed money transmitting businesses.[45] Further, the Financial Crimes Enforcement Network issued a guidance in 2013 that clarified that "virtual currency exchangers constitute 'money transmitters' under its regulation" and thus because Faiella did not register its business, it was illegally running the service.[46] Both *Ulbricht* and *Faiella* appear to reflect an ideology among judges that Bitcoin should count as currency for money laundering purposes.[47]

Despite some clarity regarding where Bitcoin fits within the federal money-laundering scheme being provided in 2014, the two

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[40] *See Ulbricht*, 31 F. Supp. 3d at 546.

[41] *Id.* at 547.

[42] *Id.* at 570.

[43] *Id.*

[44] Press Release, U.S. Dept. of Justice, Manhattan U.S. Attorney Announces Charges Against Bitcoin Exchangers, Including CEO of Bitcoin Exchange Company, For Scheme to Sell and Launder Over $1 Million in Bitcoins Related to Silk Road Drug Trafficking (Jan. 27, 2014), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-charges-against-bitcoin-exchangers-including-ceo [https://perma.cc/U9WW-AHT2].

[45] *Faiella*, 39 F. Supp. 3d at 545.

[46] *Id.* at 546.

[47] *See id.* at 545.

most recent prosecutions of Bitcoin users in 2016 have shown that it is still within the judge's discretion to include or not include Bitcoin in the statutory scheme.[48] In July 2016, in *Florida v. Espinoza*,[49] Florida circuit court Judge Teresa Pooler dismissed a money laundering case on the basis that Bitcoin is not money as defined by both state and federal regulations.[50] Michell Espinoza was prosecuted for his involvement in the sale of $1,500 worth of Bitcoins to undercover police officers in Florida.[51] Espinoza, via an online Bitcoin exchange, was engaged in the business of selling Bitcoins in exchange for cash, explaining to the undercover officers that he made a profit in these transactions by purchasing Bitcoins for 10 percent under market value and selling them for 5 percent over market value.[52] Further, the officers told Esponiza that they had intended to use the Bitcoins to buy stolen credit card numbers and wanted to engage in a subsequent transaction whereby the officers traded Espinoza a share of the stolen credit card numbers for more Bitcoins, a transaction that would be considered an "unlicensed transaction", and thus illegal under Florida's "unauthorized money transmitter" law if Bitcoin counted as "currency, monetary value, or payment instrument."[53] After agreeing to this transaction, Espinoza was arrested at the meet-up and charged with illegally engaging in a money transmitting business as well as money laundering.[54]

In her opinion, Judge Pooler explained that while Bitcoin may have some characteristics in common with what we commonly refer to as money, the uniqueness of this virtual currency did not neatly fit into the anti-money laundering statutes.[55] Judge Pooler pointed to the idea that Bitcoin cannot always be exchanged for items of value; the fact that some, but not all, merchants accept Bitcoin as payment; and the fact that the value of Bitcoin is not as stable as money.[56] The Court

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[48] *See e.g.*, *Faiella*, 39 F. Supp. 3d 544; *Ulbricht*, 31 F. Supp. 3d 540.

[49] No. F14-2923 (Fla. Cir. Ct., July 22, 2016).

[50] *See* Hackett, *supra* note 7.

[51] Hackett, *supra* note 7.

[52] *Espinoza*, No. F14-2923 at 2.

[53] *Id.*; John K. Londot, *Bitcoin Trading Isn't Money Laundering, But For How Long?*, LAW360 (Aug. 8, 2016, 3:27 PM), https://www.law360. com/articles/825837/bitcoin-trading-isn-t-money-laundering-but-for-how-long- [https://perma.cc/5W3V-K6LN].

[54] *Espinoza*, No. F14-2923 at 3.

[55] Londot, *supra* note 53.

[56] Bogage, *supra* note 5.

held that, therefore, Bitcoin cannot be characterized as money.[57] Further, using statutory interpretation to interpret terms such as "money," "currency," and "payment instruments" in Florida's "unauthorized money transmitter" law and anti-money laundering statute, Judge Pooler ruled that Espinoza's actions did not violate either of these laws and thus was not guilty of money laundering.[58] In Judge Pooler's view, "it is very clear, even to someone with limited knowledge in [economics], that bitcoin has a long way to go before it is the equivalent of money."[59]

However, only two months later, in September 2016, in Manhattan, U.S. District Judge Alison Nathan ruled that Bitcoin is to be treated as money for the purposes of hacking attacks made against J.P. Morgan Chase & Co.[60] In *United States v. Murgio*,[61] Murgio and others were charged with operating Coin.mx, an unlicensed money transmitting business that exchanged Bitcoins for cash to victims of hacking attacks.[62] These victims had to pay a sum of money, typically in Bitcoins, to the criminals who hacked them and thus the Bitcoins exchanged through Coin.mx were used to pay the criminals.[63] Similar to *Espinoza*, the decision turned on the statutory interpretation by the judge of a federal law that deems the operation of an unlicensed money-transmitting business a crime.[64] In her opinion, she discussed the meaning of the word "fund," explaining "bitcoins are funds within the plain meaning of that term" because they can be "accepted as a payment for goods and services or bought directly from an exchange

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[57] *See supra* note 56 and accompanying text.

[58] Londot, *supra* note 53.

[59] *Espinoza*, No. F14-2923 at 6.

[60] Euny Hong, *Bitcoin Is Money, Rules Federal Judge in Landmark Case (JPM),* INVESTOPEDIA (Sept. 20, 2016), http://www.investopedia.com/news/Bitcoin-money-rules-federal-judge-landmark-case-jpm/ [https://perma.cc/W6ES-ANXB]; Gershman, *supra* note 7.

[61] No. 15-cr-769 (AJN), 2016 U.S. Dist. LEXIS 131745 (S.D.N.Y. Sept. 19, 2016).

[62] Press Release, Fed. Bureau of Investigations, Manhattan U.S. Attorney Announces Charges Against Two Florida Men for Operating an Underground Bitcoin Exchange (July 21, 2015), https://www.fbi.gov/contact-us/field-offices/newyork/news/press-releases/manhattan-u.s.-attorney-announces-charges-against-two-florida-men-for-operating-an-underground-bitcoin-exchange [https://perma.cc/Z6BW-KLKT].

[63] *Id.*

[64] *Id.*

with a bank account."[65] These recent cases, coupled with prosecutions from the past few years, demonstrate that the government is still very unsure about whether Bitcoin should be afforded the same treatment as traditional money and currency. Regulators continue to struggle on how best to regulate Bitcoin in order to optimize the benefits of the virtual currency while eliminating criminal activity.[66]

D.   Regulation of Bitcoin

1.   Recent Clarifications of Bitcoin Within Money Laundering Regulation

Because Bitcoin is relatively new and users and regulators are constantly uncovering new ways the technology can be used, the government has struggled to find a way to fit Bitcoin into the statutory definitions of currency and other financial instruments.[67] In recent years, several federal regulatory bodies, including the Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of the Treasury, the IRS, and the CFTC have released statements regarding the regulation of virtual currencies in response to the rise in criminal activities surrounding Bitcoins.[68]

On March 18, 2013, FinCEN issued a guidance clarifying the differences between currency and virtual currency.[69] It also clarified the differences between specific entities and persons involved in virtual currency transactions who are subject to the regulations set forth in the BSA in an effort to clarify which Bitcoin participants can be defined as a money transmitter.[70] The guidance defines virtual currency as "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency."[71] Many, such as Judge Rakoff in *United States v. Faiella*,

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[65] Hong, *supra* note 60.

[66] *See generally Faiella*, 39 F. Supp. 3d 544; *Ulbricht*, 31 F. Supp. 3d 540; Gershman, *supra* note 7; Londot, *supra* note 53.

[67] BRITO & CASTILLO, *supra* note 8, at 41.

[68] *See id*. at 2.

[69] *See generally* FIN. CRIMES ENF'T NETWORK, U.S. DEP'T OF THE TREAS., FIN-2013-G001, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (2013).

[70] *Id*.

[71] *See id.*

have read this to say that Bitcoin should be treated as currency.[72] Others, such as Judge Pooler in *Florida v. Espinoza*, disagree, demonstrating that despite this classification, discrepancies in its interpretation still exist.[73]

On March 25, 2014, the IRS sent out a notice which defined Bitcoin as a "convertible virtual currency" that "functions as a medium of exchange" and "operates like 'real' currency" but "does not have legal tender status in any jurisdiction."[74] Thus, Bitcoin and other virtual currencies are treated as property for federal tax purposes rather than being treated as actual currency.[75] This means that, unlike currency, any gain made from selling Bitcoins is taxable income that must be reported on an income tax return.[76] However, the IRS is currently realizing that this notice has had less impact than expected, as it is currently investigating Bitcoin users who have seemingly used Bitcoin to make money while evading taxes.[77] More specifically, the IRS sent a request to Coinbase, "the largest Bitcoin exchange in the United States," on November 17, 2016 requesting the "records of all customers who bought virtual currency from the company from 2013 to 2015" in order to demand back taxes, likely from the largest customers on the exchange.[78] The IRS has discovered that the "likelihood of underreporting is significant" because Bitcoin transactions do not go through a third-party, which means there is no real way to report the transactions and thus makes it easier for someone to evade taxes.[79] This recent discovery by the IRS will most

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[72] *See supra* note 60 and accompanying text.

[73] *See supra* note 50 and accompanying text.

[74] I.R.S. Notice IR-2014-36 (Mar. 25, 2014) [https://perma.cc/D6NT-PAWT].

[75] *Id.*

[76] Rebecca Campbell, *IRS at a Standstill With Bitcoin; Users and Tax Professionals Remain in the Dark*, CRYPTOCOINS NEWS (Oct. 8, 2016), https://www.cryptocoinsnews.com/irs-standstill-bitcoin-users-tax-professionals-remain-dark/ [https://perma.cc/7GHU-UT62].

[77] Nathaniel Popper, *Bitcoin Users Who Evade Taxes Are Sought by the I.R.S.*, N.Y. TIMES: DEALBOOK (Nov. 18, 2016), http://www.nytimes.com/2016/11/19/business/dealbook/irs-is-seeking-tax-evaders-who-use-bitcoin.html?_r=0 [https://perma.cc/D3WZ-92Z6].

[78] *Id.*

[79] Kelly Phillips Erb, *IRS Wants Court Authority to Identify Bitcoin Users & Transactions at Coinbase*, FORBES (Nov. 21, 2016), http://www.forbes.com/sites/kellyphillipserb/2016/11/21/irs-wants-court-authority-to-identify-bitcoin-users-transactions-at-coinbase/2/#767c4f834183 [https://perma.cc/2ZLA-GZKL].

likely urge the IRS to further define Bitcoin and other virtual currencies so as to close the gap of illegal activities.[80]

In September 2015, the CFTC issued an order finding that Bitcoin and other similar virtual currencies are to be defined as commodities.[81] The implications of this order means that the CFTC now has jurisdiction to provide oversight and subject Bitcoin trading of futures and options contracts to CFTC regulations.[82] This order was filed simultaneous to the CFTC settling charges against Coinflip, Inc., [83] a Bitcoin options trading platform that was illegally connecting Bitcoin option contract buyers and sellers.[84] Coinflip, Inc. consented to the order and is now regulated by the CFTC and will have to remain in compliance with the Commodity Exchange Act (CEA) and CFTC regulations in order to remain as a legal commodity options facility.[85] More recently, CME Group, the largest futures exchange operator in the world, "launched a pair of indexes designed to track" the price of Bitcoin in the hopes of boosting the virtual currency's visibility in the market.[86] Currently, trading Bitcoin is less accessible because there are dozens of Bitcoin exchanges, a trader has to set up an account on each individual exchange, and many are hesitant to trade Bitcoin because of its past involvement in illegal activities.[87] However, if CME's index

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[80] Campbell, *supra* note 76.

[81] Luke Kawa, *Bitcoin Is Officially a Commodity, According to U.S. Regulator*, BLOOMBERG (Sept. 17, 2015), http://www.bloomberg.com/news/articles/2015-09-17/Bitcoin-is-officially-a-commodity-according-to-u-s-regulator [https://perma.cc/TZL5-EQ8Y].

[82] *See id.*

[83] *See generally* U.S. COMMODITY FUTURES TRADING COMM'N, ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 6(C) AND 6(D) OF THE COMMODITY EXCHANGE ACT, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS, NO. 15-29, Sept. 17, 2015, http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinflipror der09172015.pdf [https://perma.cc/BQK6-RBR9].

[84] Press Release, U.S. Commodity Futures Trading Comm'n Release, CFTC Orders Bitcoin Options Trading Platform Operator and its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps without Registering (Sept. 17, 2015), http://www.cftc.gov/PressRoom/PressReleases/pr7231-15 [https://perma.cc/XE3Q-XM62].

[85] Kawa, *supra* note 81.

[86] Alexander Osipovich, *Bitcoin Futures Might Be Coming Soon*, WALL ST. J. (Nov. 14, 2016), http://www.wsj.com/articles/bitcoin-futures-might-be-coming-soon-1479143252 [https://perma.cc/8G9C-LVGT].

[87] *Id.*

leads to greater transparency of the virtual currency, it is possible that this could lead to "futures contracts that would make it easier for both professional and individual investors to trade bitcoin."[88] This in turn could possibly lead to Bitcoin gaining more credibility as a viable virtual currency and open the door for many other avenues of positive influence.[89]

2.   The Future of Bitcoin

As with all new technology, Bitcoin has attempted to grow since its inception in 2009 to become a mainstream crypto-currency that goes beyond the sphere of what paper currency offers the world. The biggest issue facing Bitcoin currently is that "the same attributes . . . that attract lawful users, such as the capacity for anonymity as well as their speed and global reach, attract criminal actors engaged in illicit financing." [90] It might be necessary now for regulators to focus heavily on the proper classification of the virtual currency within the anti-money laundering scheme in order to combat illicit activities associated with Bitcoin. Such clarity could benefit the world, as Bitcoin has the potential to improve human welfare if the criminal consequences could be properly minimized by appropriate regulation.[91]

One possible answer would be to regulate Bitcoin out of existence or outlaw it completely, as other countries such as Russia and China have sought to do.[92] Proponents of this solution are more concerned about the anonymity of the decentralized network enabling criminals to easily launder money rather than the many advantages of Bitcoin.[93] However, many legislators are quick to point out that paper money, like Bitcoin, also can be used in illegal transactions, yet regulating paper bills out of existence has yet to be suggested.[94] Further, because of the decentralized virtual network that Bitcoin operates over, it is likely impossible to completely shut down the

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[88] *Id.*

[89] *Id.*

[90] FIN. CRIMES ENF'T NETWORK, U.S. DEP'T OF THE TREAS., SAR STATS TECHNICAL BULLETIN (July 2014).

[91] BRITO & CASTILLO, *supra* note 8, at 67.

[92] Londot, *supra* note 53.

[93] Hackett, *supra* note 7.

[94] BRITO & CASTILLO, *supra* note 8, at 67.

network even if it becomes outlawed.[95] This has the potential to completely hinder the advantages of Bitcoin by virtually banning any legal uses of Bitcoin while encouraging illegal activities to continue over a network that will continue to run unregulated.[96]

A more balanced approach would be to focus on where illegality within the Bitcoin market lies and try to specifically regulate those instances. The issue lies, as seen in cases such as *Ulbricht*, *Faiella*, and *Espinoza*, with Bitcoin companies that exchange this cryptocurrency for real currency.[97] Thus, regulation should target institutions that allow these types of transactions by subjecting them to money transmitter regulations.[98] If Bitcoin exchanges are identified as money transmitters, they will be required to file SARs, which would "allow government agencies to ascertain the identity of any individual who converts Bitcoins into at least $10,000."[99] Therefore, a reduction in potential criminal activity would likely occur because criminals could no longer stay anonymous in the Bitcoin framework.[100] This progress is already reflected in the ability of the New York State Police to trace "bank deposits back to a number of drug deals conducted in Bitcoin on an online drug market" after receiving information via SARs.[101] Because this would only target Bitcoin institutions who deal in real and virtual currency transactions, other exchanges that simply exchange Bitcoin for goods will remain relatively untouched and can continue to thrive as a quick and cheap method of exchange.[102]

This might be a better solution than attempting to regulate the Bitcoin economy as a whole. Certain state regulations have seen the backlash from Bitcoin startups when regulation appears too overinclusive. The New York Department of Financial Services (NYDFS) developed new money-transmitter regulations in a

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[95] Londot, *supra* note 53.

[96] BRITO & CASTILLO, *supra* note 8, at 68.

[97] *See generally Faiella*, 39 F. Supp. 3d 544; *Ulbricht*, 31 F. Supp. 3d 540; *Espinoza*, No. F14-2923.

[98] Singh, *supra* note 1, at 49.

[99] *Money Services Business (MSB) Suspicious Activity Reporting*, *supra* note 36 and accompanying text; Singh, *supra* note 1, at 49.

[100] *Id*.

[101] Michael del Castillo, *New York Police Win FinCEN Award for Bitcoin Investigation*, COINDESK (May 13, 2016), http://www.coindesk.com/new-york-police-win-fincen-award-bitcoin-investigation/ [https://perma.cc/J2XZ-KQKZ].

[102] *Id*.

framework called 'BitLicense,' effective August 8, 2015, which explicitly regulated virtual currencies like Bitcoin.[103] However, rather than the influx of applications for a BitLicense that regulators hoped for, it appeared that many Bitcoin startups decided to stop servicing the New York area.[104] Along with an application cost of $5,000, the BitLicense also required extensive paperwork that required the help of lawyers to understand, thus adding to the cost.[105] The biggest critics of this regulation stated that "Bitcoin was intended to give people true control and access to their money," but restrictions such as BitLicense try to centralize an otherwise decentralized network.[106]

Nonetheless, with the potential influence from the CME index, one might predict that Bitcoin will become a more generally accepted form of virtual currency in the future. In addition to CME, Cameron and Tyler Winklevoss have recently chosen State Street Corp. "to help them launch a new exchange-traded fund" (ETF) based on Bitcoin.[107] If the SEC approves the ETF, this could be another step in the transparency and acceptance of Bitcoin technology.[108] As more products emerge backed by Bitcoin technology, the more widely accepted the use of this virtual currency will become. In addition, stabilizing the more erratic nature of the market price of Bitcoin would likely lead to even more acceptance among investors and potential extend beyond the financial world.[109]

E.   Conclusion

Bitcoins' revolutionary technology certainly brings a new level of innovation to business, payment systems, and communication across the world. However, just as many technological developments

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[103] Karen Freifeld, *NY Regulator Issues First License for Bitcoin Company*, REUTERS (Sept. 22, 2015), http://www.reuters.com/article/us-Bitcoin-regulations-idUSKCN0RM1TP20150922 [https://perma.cc/SH4N-CQQ9].

[104] *See* Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups From New York*, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/ [https://perma.cc/T3K5-9S2F].

[105] *Id.*

[106] *Id.*

[107] Paul Vigna, *Winklevoss Brothers Choose State Street to Help Launch Bitcoin ETF*, WALL ST. J (Oct. 18, 2016), http://www.wsj.com/articles/winklevoss-brothers-choose-state-street-to-help-launch-bitcoin-etf-1476825213 [https://perma.cc/CK49-LUWT].

[108] *Id.*

[109] *See id.*

from the past, the advantages of a virtual currency payment system also faces the threat from criminal activities occurring over a pseudonymous network where there is virtually no current regulation to cover illegal transactions. Legislative changes are certainly forthcoming, as states and federal regulators have already taken steps to define Bitcoin in the regulatory scheme. The biggest challenge will be to regulate Bitcoin without hindering the potential for growth. While there is almost always certainly a chance that Bitcoin, like any new technological venture, could fail or be pushed out of existence by a newer, more innovative technology, policymakers must be careful not to hinder a technology that could change the way our global economy functions. Based on the most recent innovation of CME announcing two Bitcoin indexes, pushing this virtual currency out of existence seems unlikely. Instead, CME has hopefully started a radical change in bringing more transparency to Bitcoin so that regulators and potential users better understand and appreciate this technology.

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