

JUNE 8, 2022 | PUBLICATION

Breaking Down the New Bitcoin Bill: An Overview of the Lummis-Gillibrand Responsible Financial Innovation Act

SERVICE LINE

Litigation & Disputes

RELATED PROFESSIONALS

Christian H. Staples

MEDIA CONTACT

Wendy M. Byrne

wbyrne@shumaker.com

Download Client Alert: Breaking Down the New Bitcoin Bill: An Overview of the Lummis-Gillibrand Responsible Financial Innovation Act

On January 3, 2009, the pseudonymous “Satoshi Nakamoto” mined the first bitcoin. In the years following bitcoin’s creation, the price of a single bitcoin has increased exponentially, from essentially zero to an all-time high of nearly \$69,000 in October 2021, cementing its legacy as one of the greatest investment opportunities in history. The rise of bitcoin has spawned explosive growth in the burgeoning cryptocurrency and digital asset industry, which remains largely unregulated both here in the United States and globally.

Enter Senators Cynthia Lummis (R-Wyo.) and Kirsten Gillibrand (D-N.Y.), who on June 7, 2022, released their much anticipated bill designed to resolve a number of critical issues facing the cryptocurrency industry. In this article, we will examine some of the key provisions of the Lummis-Gillibrand Responsible Financial Innovation Act (hereinafter “Lummis-Gillibrand” or the “Act”).

First, Lummis-Gillibrand includes a number of definitions for key terms such as digital asset, virtual currency, payment stablecoin, smart contract, and distributed ledger technology (a/k/a blockchain). If codified into law, these definitions alone would go a long way towards establishing a framework for understanding some admittedly complex concepts.

Next, in an obvious effort to encourage greater adoption and use of cryptocurrency as an alternative form of payment and exchange of value, Lummis-Gillibrand provides an exclusion of up to \$200 per transaction (subject to an aggregation rule) from a taxpayer’s gross income for use of cryptocurrency for payment for goods or services under specified conditions.

With regard to the mining and “staking” of cryptocurrencies (typically for the purpose of earning interest or other rewards on the staked cryptocurrency), Lummis-Gillibrand declares that digital assets obtained from these activities do not form a part of a taxpayer’s gross income until the eventual disposition of those assets and conversion to fiat currency.

Importantly, Lummis-Gillibrand specifies that the default classification for a decentralized autonomous

organization (DAO) is as a business entity for purposes of the tax code, and requires most DAOs to be properly incorporated or organized under the laws of an identifiable jurisdiction, whether as a limited liability company (LLC), corporation, partnership, etc. (in basic terms, a DAO is a collective organization designed to be administered and governed without centralized leadership using smart contracts and blockchain technology). Popular DAOs include Uniswap (a decentralized exchange for swapping various forms of cryptocurrency), certain non-fungible tokens (NFTs) like the Bored Ape Yacht Club, and other decentralized finance (DeFi) applications.

While generally viewed as “friendly” to the crypto industry, Lummis-Gillibrand attempts to strike an important balance between continued innovation, decentralization, and consumer/investor protection. One of the most hotly debated areas has been *who* should regulate cryptocurrency and other digital assets. In what would be perceived as a major win for the crypto industry if passed into law, Lummis-Gillibrand grants to the Commodities Futures Trading Commission (CFTC) (as opposed to the Securities and Exchange Commission) exclusive spot market jurisdiction over all fungible digital assets which are not securities that could help pave the way for a bitcoin spot exchange-traded fund (ETF) in the United States. Lummis-Gillibrand also requires digital asset exchanges (such as Coinbase, Binance, and Crypto.com) to register with the CFTC in order to conduct trading activities and further classifies those exchanges as financial institutions subject to other existing laws.

Lummis-Gillibrand distinguishes between digital assets that should be treated as commodities versus those that should be treated as securities by codifying existing legal precedent under the *Howey* test for determining whether a transaction qualifies as an “investment contract” and is therefore, deemed a security subject to disclosure and registration requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934. The determination requires an examination of the rights or powers given to the holder of the digital asset, as well as the asset’s inherent purpose. In order to be classified as a security, the digital asset must provide the holder with a debt or equity interest in a business entity, liquidation rights or entitlement to interest or dividend payments from a business entity, a profit or revenue share in a business entity derived “solely from the entrepreneurial or managerial efforts of others,” or any other financial interest in the entity. Notably, Lummis-Gillibrand calls for most digital assets to be treated like commodities in bankruptcy proceedings.

On the other hand, payment stablecoins (a type of cryptocurrency backed by one or more non-digital financial assets and redeemable on a one-to-one basis for instruments denominated in United States dollars), are defined by Lummis-Gillibrand as neither commodities nor securities, but would still be subject to significant regulation under the Act, which regulation is much needed following the recent collapse of the TerraUSD stablecoin and the reliance on stablecoins in many parts of the developing world as an alternative store of value and a hedge against inflation.

There are many other provisions contained in Lummis-Gillibrand, the full text of which can be easily found online, but the foregoing are some of the highlights.

While Lummis-Gillibrand appears to have bi-partisan support, it will be interesting to see how Congress responds in the coming weeks and months. If nothing else, it is a landmark piece of legislation that will hopefully encourage the responsible growth and development of cryptocurrencies and other digital assets and promote further discussion regarding the need for regulation of this promising new industry.

Christian Staples is a Partner in the Charlotte office of Shumaker. He bought his first bitcoin in 2017 and owns several NFTs. He can be reached at cstaples@shumaker.com