Comments to the Federal Elections Commission on Technological Modernization

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Introduction

Coin Center is a non-profit research and advocacy center focused on the public policy issues facing open and decentralized blockchain technologies. Specifically, our focus encompases cryptocurrencies (*e.g.* Bitcoin), decentralized computing platforms (*e.g.* Ethereum) and inter-ledger systems and protocols (*e.g.* sidechains). Our mission is to build a better understanding of these technologies and to promote a regulatory climate that preserves the freedom to innovate using them. We do this by producing and publishing policy research from respected academics and experts, educating policymakers and the media about decentralized blockchain technology, and by engaging in advocacy for sound public policy. In that spirit, please find below our comments on the recent Federal Elections Commission notice of proposed rulemaking (NPRM) regarding technological modernization.[1]

The Commission seeks to understand "the unique nature of bitcoin" to determine what challenges, if any, it and other similar cryptocurrencies may pose under existing rules and regulations. In this comment letter we address some of the specific questions asked by the Commission, clear up some commons misconceptions, and make some specific recommendations about how bitcoin contributions should be treated.

Bitcoin contributions should be treated as in-kind contributions.

While Bitcoin is often referred to as a digital currency because it is used in payments and denominated like a currency (*i.e.* ฿1.25), it is actually more akin to gold or other scarce commodities. Like gold, there is a fixed amount of bitcoins in existence and there is no central organization or institution that issues them or controls their circulation.[2] This is in contrast to traditional fiat currencies that rely on government monetary policy and central bank issuance to create them and determine their supply. Indeed, the monetary economist George Selgin has labeled bitcoin "synthetic commodity money," recognizing that it is a

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[1] Federal Elections Commission, Notice of Proposed Rulemaking on Technological Modernization, Nov. 2, 2016, (81 Fed. Reg. 76416) ("NPRM")
[2] Jerry Brito & Andrea Catillo, Bitcoin: A Primer for Policymakers, Mercatus Center at George Mason Univeristy (2016), at 9, available at
https://www.mercatus.org/system/files/GMU_Bitcoin_042516_WEBv2_0.pdf

commodity often employed as money (as gold has been historically) but synthetic because its scarcity does not derive from nature but from a breakthrough in cryptography.[3]

In part because of these distinctions, the Commodities Futures Trading Commission, which oversees derivative exchange markets for both currencies and commodities, has classified bitcoins as a commodity like gold.[4] The Internal Revenue Service has similarly determined that the appropriate tax treatment of bitcoin is not as "money," but as "property."[5] The Commission should, therefore, consider treating bitcoin contributions the same way it would treat contributions of gold or other valuable commodities–as an in-kind contributions subject to the rules for such contributions.

Bitcoin is not as cash-like as is often assumed.

The Commission is also interested in understanding whether bitcoin poses a challenge to achieving meaningful disclosure and cites FECA's legislative history and Congress's concern with the "untraceability" of cash.[6] The Commission also notes that in Advisory Opinion 2014-02 (Make Your Laws PAC), it determined that a political committee could only accept up to $100 worth of bitcoin contributions per contributor per election given bitcoin's perceived cash-like qualities.[7] Bitcoin does not present the same challenges as cash and the Commission should remove that special contribution limit.

It is a common misconception that bitcoin transactions are anonymous and untraceable like cash.[8] Unlike cash, every bitcoin transaction is recorded in a public ledger known as the blockchain. These records make Bitcoin the complete opposite of "untraceable." As Jason Weinstein, a former federal prosecutor and Deputy Assistant Attorney General in the Department of Justice's Criminal Division, has explained:

> Bitcoin and the blockchain provide significant advantages for law enforcement[]. The most obvious is that the blockchain allows one to trace all transactions involving a given bitcoin address, all the way back to the first transaction. That gives law

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[3] George Selgin, Synthetic Commodity Money, April 10, 2013, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2000118

[4] Luke Kawa, *Bitcoin Is Officially a Commodity, According to U.S. Regulator*, Bloomberg, Sept. 17, 2015, available at https://www.bloomberg.com/news/articles/2015-09-17/bitcoin-is-officially-a-commodity-according-to-u-s-regulator; CFTC, Order: Coinflip, Inc., d/b/a Derivabit, et al, Sept. 17, 2015, avaiable at http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf

[5] IRS, IRS Virtual Currency Guidance : Virtual Currency Is Treated as Property for U.S. Federal Tax Purposes; General Rules for Property Transactions Apply, Mar. 25, 2014, available at https://www.irs.gov/uac/newsroom/irs-virtual-currency-guidance

[6] NPRM at 76429-30.

[7] FEC, Advisory Opinion 2014-02 (Make Your Laws PAC), available at http://saos.fec.gov/aodocs/2014-02.pdf

[8] Adam Ludwin, How Anonymous is Bitcoin?, Coin Center, Jan. 20, 2015, available at http://coincenter.org/entry/how-anonymous-is-bitcoin

> enforcement the records it needs to "follow the money" in a way that would never be possible with cash.[9]

Indeed, federal prosecutors have used blockchain records to tie criminals to illicit transactions.[10] Law enforcement is increasingly becoming adept at employing blockchain forensics. As Edward Lowery III, Special Agent in Charge Criminal Investigative Division of the U.S. Secret Service, told the Senate Homeland Security Committee's inquiry into digital currencies,

> The public ledger feature of the Bitcoin blockchain differentiates Bitcoin, and other decentralized digital currencies, from many of the centralized digital currencies, such as e-gold and Liberty Reserve. The blockchain makes it harder for criminals to hide their illicit activity. The work of researchers to link known transactions to individual identities reduces the attractiveness of Bitcoin for criminal activities. This research also provides an additional tool for law enforcement to identify illicit transactions, assets and the individuals associated with this activity in support of apprehension, asset forfeiture, and prosecution.[11]

Although bitcoin transactions may be traceable, it is important to note that user identities are not recorded on the blockchain. Otherwise, users would have no financial privacy as the blockchain is completely public. Indeed, the Commission quotes a GAO report stating that "all that is needed to complete a [bitcoin] transaction is a bitcoin address, which does not contain any personal identifying information."[12] This might lead one to assume that it is difficult to tie bitcoin transactions to individuals, but that is another misconception.

In its Notice of Proposed Rulemaking, the Commission writes that "Like currency … some internet-based alternative mediums of exchange … are not associated with a depository institution and thus are not subject to those institutions' 'know-your-customer' obligations under federal law."[13] This may be the case with some internet-based alternative media of exchange, but it is certainly not the case with bitcoins. The Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued guidance in March of 2013 clarifying that bitcoin exchanges and payment processors are financial institutions under the Bank Secrecy

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[9] Jason Weinstein, How can law enforcement leverage the blockchain in investigations?, Coin Center, May 12, 2015, available at
http://coincenter.org/entry/how-can-law-enforcement-leverage-the-blockchain-in-investigations
[10] Jerry Brito, Silk Road corruption case shows how law enforcement uses Bitcoin, Coin Center, April 1, 2015, available at
https://coincenter.org/entry/silk-road-corruption-case-shows-how-law-enforcement-uses-bitcoin
[11] Hearing Before the Senate Homeland Security and Governmental Affairs Committee, Beyond Silk Road: Potential Risks, Threats, and Promises of Virtual Currencies, Nov. 18, 2013, available at
http://www.gpo.gov/fdsys/pkg/CHRG-113shrg86636/pdf/CHRG-113shrg86636.pdf
[12] NPRM at 76428, *quoting* U.S. Gov't Accountability Office, GAO-13-516, Virtual Economies and Currencies 8 (2013), available at gao.gov/assets/660/654620.pdf.
[13] *Id*. at 76429.

Act (BSA) and thus are subject to the BSA and FinCEN's implementing regulations.[14] This includes registering with FinCEN, complying with know-your-customer and recordkeeping obligations, filing suspicious activity reports, and undergoing periodic examinations. To transact in bitcoins one must first acquire bitcoins, and this is typically done through BSA-regulated intermediaries that record one's identity and are subject to subpoena by law enforcement. Additionally, in most instances that we have observed, political committees accept bitcoin contributions using a BSA-regulated payment processor.[15]

Bitcoin contributions should not be subject to a $100 limit.

Bitcoin financial institutions today are as regulated today as are banks when it comes to KYC/AML. Given that political committees are responsible for collecting and reporting contributor information, and given that both contributors and political committees will typically be employing BSA-regulated intermediaries to transact with bitcoins, from a disclosure perspective bitcoin contributions look no more risky than credit card transactions. The Commission should therefore reconsider its $100 limits for bitcoin donations. At the very least, the Commission should lift the $100 cap on political committees that employ a BSA-regulated payment processor.

There are essentially two ways that a political committee will use Bitcoin to accept contributions. The first is by taking possession of the bitcoins itself in its own wallet, without employing any third party whatsoever, and liquidating them for dollars at a later date. The other method, which will likely be more typical, is to employ a BSA-regulated third-party payment processor like BitPay or Coinbase. Such a payment processor will take possession of the contribution on behalf of the political committee and, if the political committee chooses, immediately upon receipt liquidate the bitcoins for dollars that can then be deposited by the committee. The latter option, is no different than using a bank wire transfer or credit card network to accept contributions.

Using a bank wire, the committee can receive dollars yet never touch cash, even if the contributor deposited cash into his bank account in order to fund the transfer. The financial intermediaries involved in a bank transfer are BSA-regulated and comply with KYC/AML obligations, and the political committee notes the contributor's identity when the contribution is made, so normal contribution limits apply. Bitcoin contributions made through a regulated payment processor should be no different. The political committee receives dollars even though the contributor may have funded the contribution in bitcoins, and the contributor and the contribution happens through a BSA-regulated financial institution.

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[14] FinCEN, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, Mar. 18, 2013, available at
https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf
[15] *See, e.g.*, Stan Higgins, *Rand Paul Accepts Bitcoin for Presidential Campaign*, CoinDesk, April 7, 2015, available at http://www.coindesk.com/rand-paul-presidential-campaign-bitcoin-donations/

Conclusion

In conclusion, because bitcoin is a commodity, bitcoin contributions are best treated as in-kind donations. And because bitcoins are not as cash-like as is often perceived, bitcoin contributions should not be subject to a special $100 limit. At the very least, bitcoin contributions made through BSA-regulated payment processors should not be limited.