ACG® Raleigh Durham

ACG 2018 Raleigh Durham's Capital Conference Wrap-Up:

Insights from the Crypto Economics Panel "Investors Need a Compliance Strategy"

This is the third in a series of articles summarizing the key ideas of the 2018 Capital Conference.

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Despite the promise of blockchain and cryptocurrencies, the hype that surrounds them is creating risks for investors, a state regulator told attendees at the Association of Corporate Growth Raleigh Durham chapter's 2018 Capital Conference.

"We have serious concerns about the illegitimate actors in this space," said Kevin Harrington, Director of the Securities Division at the N.C. Secretary of State's office. "We have a lot of people who have lost money."

Some initial coin offerings (ICOs), Harrington said, amount to little more than a website, a white paper and some hype. Nonetheless, some people get "caught up in the YouTube videos," he said. They spend money to buy into these ICOs, and then, "Websites go dead, ICOs go dead." And their money is gone.

Jonathan Kraftchick, a CPA and Managing Director of Assurance Services at Cherry Bekaert, moderated the panel, and asked Harrington if the hype surrounding cryptocurrencies reminded him of the late 1990s excitement around the Internet.

“You can see the similarities,” Harrington said. “I don’t know where cryptocurrencies and blockchain technologies will go in general, but the one thing we all agree is there are bad actors out there.”

Other panelists said cryptocurrency investors need to be smart and carefully assess new ICOs.

“If there’s not a management team in your white paper,” said Margaret Rosenfeld, an attorney at Smith Anderson, and if there’s “a lot of broken English in it ... It’s probably a bad actor.”

Whether it’s a cryptocurrency or a blockchain company, though, investors need to be mindful of taxes and regulations, even if some of the rules are still being sorted out by authorities. And because there is so much blockchain activity internationally, companies have to consider where they’re doing business and who’s regulating them.

“We serve clients all around the world,” said Robert Massey, a tax partner at Deloitte’s San Francisco office. “I think a lot of the guidance that has come out from our regulators has been fairly balanced.”

Massey said that although the U.S. hasn't publicly sought to attract blockchain companies by making regulations especially attractive, companies should carefully consider all the tax and legal consequences of where they do business.

"You can be welcoming to the commerce, but when it comes to taxation and security law, it's not as friendly," he said.

And the current vagueness in regulations doesn't necessarily mean that individuals and companies will be exempt from future rules. Transactions on Bitcoin's blockchain, for example, are essentially public information for those with technical know-how. "This is all on the blockchain," Massey said. "[Regulators will] take their sweet time."

Rosenfeld noted that there are a number of state and federal regulatory agencies. Companies, she said, need to be mindful not only tax and securities laws, but also privacy rules and other regulations. The state of Massachusetts, she said, "has gone hard after a bunch of companies."

So how can investors and entrepreneurs protect themselves when regulatory approaches are still being worked out? Get good advice.

"Get competent legal counsel that knows securities law," Harrington said. "If you don't do it right up front, the consequences are really significant."

At a minimum, that should include reporting any transactions made with cryptocurrencies and being sure to file IRS FBAR forms, required of any U.S. resident who holds or has control over foreign bank or financial accounts with more than $10,000 in assets.

Mitch Mumma, a seasoned venture capitalist with Durham-based Intersouth Partners, echoed the focus on doing things right at the start.

"I have a company right now that's in the throes of considering an ICO," he said. "I'm trying to make sure I do the right thing."

Mumma noted that many start-ups don't have the resources, such as a fully staffed treasury office, that more established companies do. And that blockchain companies often have business models that are unproven. That can make it more challenging for small, new companies to muster the resources to make sure they handle cryptocurrency transactions in a legal way.

But Harrington, state regulator said it's worth spending the money up front, rather than trying to cut costs by cutting corners.

"There are compliance strategies that exist right now where you can do an ICO," he said. "You can do ICOs today here in the United States, and I think you can attract investors."

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