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STABLECOINS: US AND UK REGULATORY AND TAX TREATMENT

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Topics

- **Nick Moore: Introduction: Stable coins**
- **Christine Lombardo & Sarah Riddell: US regulatory treatment of stablecoins**
- **Steven Lightstone: UK regulatory treatment of stablecoins**
- **Sarah-Jane Morin: US tax treatment of stablecoins**
- **Neil McKnight: UK tax treatment of stablecoins**

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SECTION 01

INTRODUCTION

Introduction: Stable Coins

- Cryptoassets vs stablecoins – an introduction
- The shortcomings of existing payment systems
- Risks and challenges of stablecoins
- In particular, how do stablecoins fit in to existing regulatory frameworks?
- Public policy issues

SECTION 02

**US & UK REGULATORY
TREATMENT OF
STABLECOINS**

US Regulatory Treatment of Stablecoins continued

Concerns related to stablecoin:



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Types of stablecoin:



US Regulatory Treatment of Stablecoins continued

AML

- SEC, CFTC, FinCEN issued a joint statement in 2019 reminding persons engaged in digital asset activities that they are still obligated to comply with AML and countering the financing of terrorism obligations under the Bank Secrecy Act

Money Services Business

- FinCEN
- State considerations

SEC & CFTC Implications

- In October 2019, the SEC issued no-action relief to Paxos Trust Company, permitting Paxos Trust Company to operate a securities settlement system without registering as a clearing agency

Trust Company

- NY Department of Financial Services

State Attorney Generals

- Investigation and enforcement authority

US Legislative Efforts: DOA?

IN THE HOUSE OF REPRESENTATIVES
APRIL 9, 2019

Mr. DAVIDSON of Ohio (for himself, Mr. SOTO, Mr. GOTTHEIMER, Mr. BUDD, Ms. GABBAUD, and Mr. PERRY) introduced the following bill; which was referred to the Committee on Financial Services, and in addition to the Committee on Ways and Means, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

A BILL

To amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to exclude digital tokens from the definition of a security, to direct the Securities and Exchange Commission to enact certain regulatory changes regarding digital units secured through public key cryptography, to adjust taxation of virtual currencies held in individual retirement accounts, to create a tax exemption for exchanges of one virtual currency for another, to create a de minimis exemption from taxation for gains realized from the sale or exchange of virtual currency for other than cash, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Token Taxonomy Act of 2019”.

A BILL

To clarify which Federal agencies regulate digital assets, to require those agencies to notify the public of any Federal licences, certifications, or registrations required to create or trade in such assets, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Crypto-Currency Act
5 of 2020”.

IOSCO Report - Global Stablecoin Initiatives

Hypothetical Case Study

In March 2020, the International Organization of Securities Commissions (“IOSCO”) published a public report (the “IOSCO Report”) detailing “potential issues that may arise from stablecoins with global reach and adoption.”

To better analyze these issues, the IOSCO Report sets forth a “Hypothetical Case Study” with the following parameters (among others):

- A private company (the “Company”) issues a stablecoin (the “Coin”) that is intended to act as a means of exchange on the Company’s designed platform and is also accessible by third parties.
- The Coin will be backed by assets that are held in accounts at a number of global financial institutions (the “Reserve Fund”).
- The Reserve Fund will be managed by the Company with the goal of value preservation and liquidity, and will be composed of (i) low volatility currencies, (ii) bank deposits and (iii) sovereign debt instruments.
- Market makers and liquidity providers (the “Authorized Participants”) would maintain the trading price of the Coin at a value close to the value of the Reserve Fund through arbitrage.
- The Coin will be transferred through crypto-asset trading platforms and peer-to-peer transactions.

IOSCO Hypothetical Case Study

The CPMI-IOSCO Analysis identifies the PFMI's that are likely applicable to centralized stablecoin arrangements, partially distributed stablecoin arrangements and highly distributed stablecoin arrangements:

Principles	Centralized	Partially Distributed	Highly Distributed	Principles	Centralized	Partially Distributed	Highly Distributed	Principles	Centralized	Partially Distributed	Highly Distributed
1. Legal Basis	Applicable*	Applicable*	Applicable*	9. Money Settlements	Applicable*	Applicable*	Applicable*	19. Tiered participation arrangements	Applicable*	Applicable*	Applicable*
2. Governance	Applicable	Applicable*	Applicable*	11. CSD	Applicable**	Applicable**	Applicable**	20. Links	Applicable*	Applicable*	Applicable*
3. Framework for comprehensive management of risks	Applicable	Applicable*	Applicable*	12. Exchange-of-value settlement systems	Applicable**	Applicable**	Applicable**	21. Efficiency	Applicable	Applicable	Applicable
4. Credit Risks	Applicable	Applicable*	Applicable*	15. General Business Risks	Applicable	Applicable	Applicable	22. Communications procedures and standards	Applicable	Applicable	Applicable*
5. Collateral	Applicable	Applicable	Applicable	16. Custody	Applicable	Applicable*	Applicable*	23. Transparency	Applicable	Applicable*	Applicable*
7. Liquidity Risks	Applicable	Applicable	Applicable*	17. Operational Risk	Applicable	Applicable*	Applicable*	Annex F	Applicable	Applicable*	Applicable*
8. Settlement Finality	Applicable	Applicable*	Applicable*	18. Access and participation requirements	Applicable*	Applicable*	Applicable*				

* Indicates that CPMI-IOSCO anticipates that this Principle will be challenging to observe.

** Indicates that CPMI-IOSCO anticipates that this Principle will only be applicable in certain circumstances and, if applicable, will be challenging to observe.

UK Regulatory Treatment of Stablecoins

Treasury will consult on whether further regulation is needed in cryptoasset market

AML legislation applies to cryptoasset business

FCA encourages consistency in regulation via Global Financial Innovation Network

FCA taxonomy:

- Security tokens (regulated)
- E-money (regulated)
- Unregulated tokens

Dealing in unregulated tokens (except cryptoasset derivatives) does not require FCA authorisation

FCA does not treat stablecoins as separate category of cryptoasset

SECTION 03

US & UK TAX TREATMENT OF STABLECOINS

US Tax Treatment of Stablecoins

IRS Notice 2014-21: convertible virtual currency is treated as property.

Requires basis tracking and FMV determinations.

No specific guidance on stablecoins from the IRS or U.S. Treasury.

Open questions:

Distinguish between stablecoin and other cryptocurrencies?

Gains/losses generated by underlying basket of assets:
Taxable? Reportable? By whom?

UK Tax Treatment of Stablecoins

HM Revenue & Customs has published guidance on the UK tax treatment of cryptocurrencies (in the form of exchange tokens) but this does not specifically cover stablecoins.

Cryptocurrencies are not treated as cash, but rather are treated as assets more akin to shares.

Transactions in cryptocurrencies must be valued to calculate UK tax liabilities.

Stablecoins pegged to GBP may remove some of the issues caused by value fluctuations.

The accounting treatment of stablecoins – whether as intangibles or financial assets – may give rise to tax consequences.

SECTION 04

PRESENTATION TAKEAWAYS

Presentation Takeaways



Overview

The growth of stablecoins presents a challenge for global regulators, but also an opportunity to facilitate development of revolutionary access to the modern financial system. A successful way forward will require international collaboration and especially the alignment of the different regulatory spheres into which components of a stablecoin ecosystem will fall.



Global regulation

The cross-border nature of stablecoin gives rise to the need for consistent regulation in relevant jurisdictions. IOSCO's report demonstrates the patchwork of regulation needed to comprehensively regulate stablecoin.



US regulation

The SEC, CFTC, and FinCEN are on the forefront of crypto asset and stablecoin regulatory issues. Based on legislative efforts, we will see FinCEN take the lead on stablecoin issues with the SEC and CFTC responsible for more traditional oversight (such as clearing agency registration).

Presentation Takeaways continued



UK regulation

Stablecoins fall within existing regime, but Treasury to consult on whether further regulation needed.



US tax

Convertible virtual currency is generally addressed under U.S. tax guidance but stablecoins specifically are not.



UK tax

Cryptoassets are for UK tax purposes treated more like assets such as shares rather than cash.

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To help keep you on top of developments as they unfold, we also have launched a resource page on our website at

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If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple “Stay Up to Date” button.

Biography



Nicholas Moore

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Nick Moore's practice focuses on complex cross-border M&A, investments, joint ventures, strategic advice and corporate restructurings, with a particular focus on the fintech and TMT sectors.

His clients in the fintech sector include banks, investment banks and insurers, notably advising TSB on its separation from Lloyds, Williams & Glyn on its proposed separation from RBS and some of the largest ever transactions in the UK insurance market including the merger of Allied Zurich and Zurich Allies to create Zurich Financial Services and the acquisition by Swiss Re of GE's UK business.

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Biography



Christine M. Lombardo

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Christine Lombardo advises investment managers and broker-dealers on financial regulatory matters.

She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals.

Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products.

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Biography



Sarah V. Riddell

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Leveraging her experience as a lawyer at the US Commodity Futures Trading Commission (CFTC), Sarah V. Riddell advises domestic and foreign exchanges, derivatives clearing organizations, swap execution facilities, and other financial institutions on a broad range of regulatory matters, including CFTC registration and compliance.

Sarah also assists hedge fund clients with CFTC and National Futures Association (NFA) registration, compliance, and examination questions.

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Biography



Steven Lightstone

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Steven Lightstone advises on financial services, securities, and derivatives regulatory issues.

His clients include asset managers across a wide range of asset classes and their funds, fintech firms, banks, broker-dealers, payment institutions, institutional investors, insurers, lenders, and market associations.

Steven is a founding member of the firm’s fintech group and regularly contributes to the firm’s fintech blog.

Biography



Sarah-Jane Morin

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Sarah-Jane Morin represents public and private companies, private equity funds, venture capital funds, real estate funds, portfolio companies, and alternative investment vehicles in the tax aspects of complex business transactions and fund formations, including domestic and cross-border investment strategies, sponsor investment strategies, limited partner investment strategies, mergers, acquisitions, integrations, buyouts, recapitalizations, debt and equity restructurings, and ongoing operations and tax compliance issues.

She also advises on international tax issues, including the tax aspects of offshore vehicles (CFC/PFIC/GILTI regimes), anti-deferral rules (Subpart F), withholding, cost sharing, and transfer pricing.

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Neil McKnight advises on the full range of corporate, finance, and real estate tax matters, including corporate mergers and acquisitions (both buy and sell side), reorganisations, and real estate acquisitions, disposals and investment transactions.

Neil has a particular interest in indirect tax and VAT matters relating to cross-border transactions, particularly in the fintech and technology sectors.

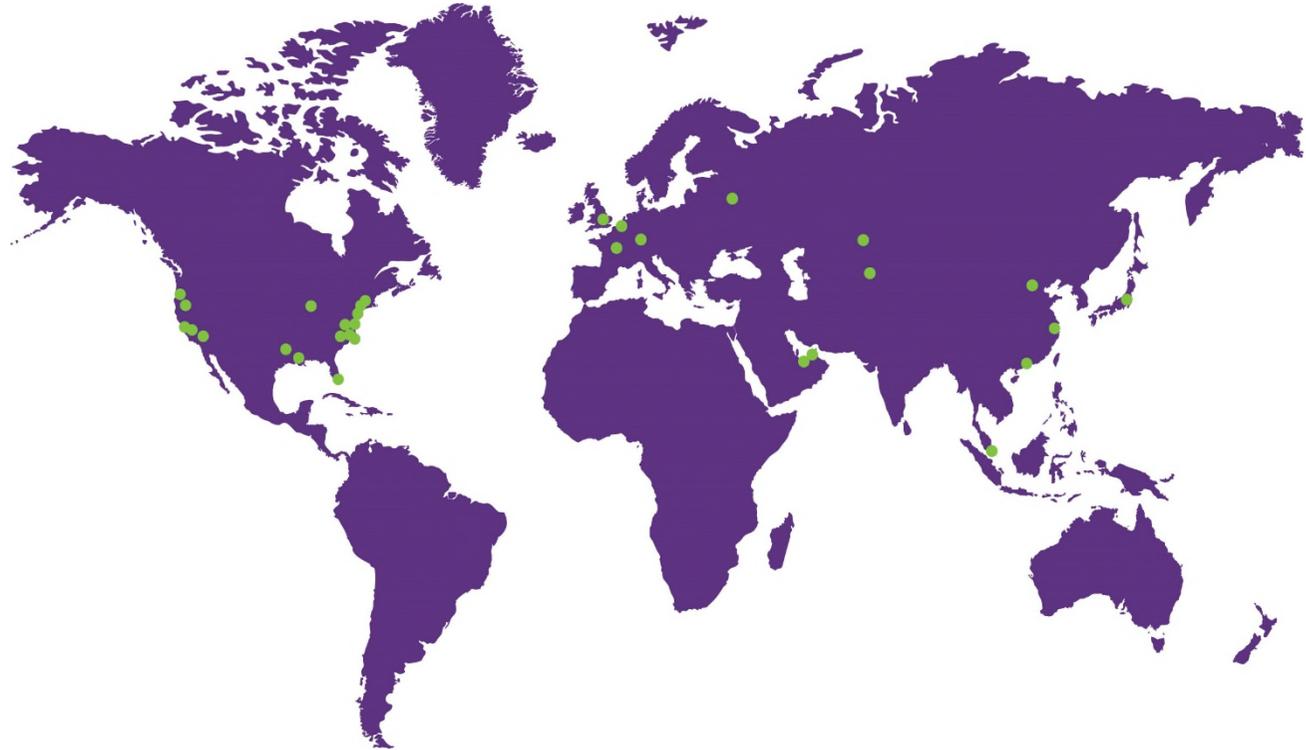
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