



Morgan Lewis

**DISRUPTIVE TECHNOLOGIES IN
INVESTMENT MANAGEMENT:
INVESTMENT FUNDS – FOCUS ON LEGAL
AND TAX ISSUES**

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Morgan Lewis Technology May-rathon 2018

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Agenda



- Brief overview of cryptocurrency
- Interplay between US tax laws and cryptocurrency
- Interplay between US securities laws and cryptocurrency
- Implications for legal practitioners, with a focus on private fund and tax aspects

Cryptocurrencies – Some Basics

- A cryptocurrency is a virtual analog of traditional money BUT
 - it uses a decentralized ledger as opposed to a central bank,
 - payments are made on a peer-to-peer basis, avoiding intermediaries, and
 - it has no intrinsic value and is not tangible.

A “virtual currency” is:

“a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status.”

- FATF Report, Virtual Currencies, Key Definitions and Potential AML/CFT Risks (June 2014)

Cryptocurrencies – Some Basics

- The most well-known cryptocurrencies (out of approximately 1,000+ types currently available) are Bitcoin (BTC), Litecoin (LTC), and Ether (ETH)
- Cryptocurrencies are used in a number of ways:
 - payment for goods and services (both legal and illegal),
 - building smart contracts, and
 - raising funds in initial coin offerings (ICOs).
- No one person is responsible for volatility management through supply

Cryptocurrencies – Some Basics



- Cryptocurrencies use blockchain to verify the transactions. Blockchain is:
 - A database,
 - That is distributed (non centralized),
 - Whose data elements are unalterable, and
 - That is encrypted (can be made public).
- A transaction on the blockchain is simply the change in the registered owner of an asset on the ledger
- Blockchain was developed to solve the problem of a “double spend” in a decentralized payment system for digital currency

Quick Stats on Tax Side

- Exponential growth over the last 5 years
- Expanding acceptance of cryptocurrencies across industries
 - In 2017 PWC and EY started accepting payments in Bitcoin
- According to the IRS, today there are more than 1,500 known virtual currencies
- From 2013 to 2017 the EurekaHedge Crypto-Currency Fund Index saw a cumulative return of 2,152% (125% on an annualized basis)
- The IRS asserts fewer than 1,000 taxpayers reported virtual currency sales on their tax returns between 2013 and 2015

HIGHLIGHTS OF FEDERAL GUIDANCE ADDRESSING CRYPTOCURRENCY TAX ISSUES

Notice 2014-21

- Notice 2014-21 addresses how general tax principles apply to transactions involving “convertible” cryptocurrency
 - Guidance is limited in scope to “convertible” cryptocurrency
 - Guidance issued in Q&A format
 - Discussed in detail *infra*

TIGTA Report

- The Treasury Inspector General for Tax Administration (TIGTA) issued 25-page report in September 2016 addressing the growth of cryptocurrencies and the then current state of the IRS engagement
- The report notes that although the IRS issued Notice 2014-21, there has been little coordination between the responsible IRS functions to address potential taxpayer noncompliance
 - None of the IRS's operating divisions have developed any type of compliance initiatives or guidelines for conducting investigations related to cryptocurrencies
- Third-party methods of reporting taxable transactions to the IRS do not separately identify cryptocurrency transactions
- The IRS should develop a cryptocurrency strategy with goals and a timeline for implementation
- The IRS should revise third-party information reporting documents to identify cryptocurrency transactions and the amounts at issue

Coinbase Summons



- November 17, 2016 the Department of Justice petitioned for the issuance of John Doe summons to examine Coinbase records for information related to any US taxpayers conducting transactions in virtual currency during the years ended December 31, 2013 through December 31, 2015.

IRS March 2018 “Reminder”

- IR-2018-71: IRS Reminds Taxpayers to Report Virtual Currency Transactions
 - On March 23, 2018, the IRS issued its short “reminder” to taxpayers as the April filing deadline for 2017 approached
 - “Virtual currency transactions are taxable by law just like transactions in any other property.”
 - Outlined guidance set forth in Notice 2014-21



IRS NOTICE 2014-21

Notice 2014-21

- Notice 2014-21 addresses how general US tax principles apply to transactions involving “convertible” cryptocurrency
 - Guidance issued in Q&A format
 - Addresses a fairly broad range of tax scenarios, but is not comprehensive
 - Important limitation: the guidance outlined in the Notice is limited in scope to “convertible” cryptocurrency, which is defined in the Notice as a virtual currency that has a value in real currency or acts as a substitute for a real currency:

“Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as a ‘convertible’ virtual currency.”
 - The Treasury and the IRS requested comments from the public regarding other types or tax aspects of cryptocurrency transactions that should be addressed in future guidance

Notice 2014-21

- Key federal tax principles from Notice 2014-21:
 - Convertible cryptocurrency is treated as property for US federal income tax purposes
 - General tax principles applicable to property transactions apply to transactions using cryptocurrency
 - Cryptocurrency is not a “foreign currency” for US tax purposes
 - Transactions involving cryptocurrency must be reported in US dollars



Notice 2014-21

- Notice 2014-21 guidance highlights:
 - Receipt of cryptocurrency as payment for goods or services
 - Taxpayer must, in computing gross income, include the fair market value of the cryptocurrency measured in US dollars, as of the date of the receipt
 - The taxpayer's basis in the cryptocurrency is the same fair market value amount, measured in US dollars
 - Exchange of cryptocurrency for other property
 - Taxpayer realizes gain or loss based on difference of the tax basis (or bases) of the exchanged cryptocurrency and the fair market value of the acquired property (note assumption of equal value exchange)
 - The gain/loss is capital or ordinary based on whether the cryptocurrency is a capital asset in the hands of the taxpayer

Notice 2014-21

- Notice 2014-21 guidance highlights, cont.:
 - Taxpayers who “mine” cryptocurrency
 - Realize gross income upon the receipt of the cryptocurrency from the mining efforts
 - Amount included in gross income is determined based on the fair market value of the cryptocurrency that is received
 - Tax basis established on that date, and holding period starts
 - If a taxpayer’s mining of cryptocurrency constitutes a trade or business (not a hobby), and is not undertaken as an employee, the net earnings constitute self-employment income and are subject to self-employment tax
 - Cryptocurrency received by an independent contractor for performing services (such as mining) are subject to self-employment tax

Notice 2014-21

- Notice 2014-21 guidance highlights, cont.:
 - Cryptocurrency paid to employees
 - Cryptocurrency paid by an employer for services performed by an employee constitutes “wages” for tax purposes
 - Cryptocurrency wages are subject to federal income tax withholding, Federal Insurance Contributions Act (FICA) tax, and Federal Unemployment Tax Act (FUTA) tax, and must be reported on Form W-2; all measured based on the fair market value of the cryptocurrency when paid to the employee
 - Cryptocurrency and information reporting requirements and withholding
 - Payments made using cryptocurrency are subject to IRS information reporting requirements and potential withholding
 - For example, payments of \$600 or more to an independent contractor during any year must be reported to the payee and IRS on Form 1099-MISC
 - Backup-withholding rules apply

BASIS, HOLDING, AND CHARACTER ISSUES FOR OWNERS OF CRYPTOCURRENCY

Basis Issues



- Each bitcoin owned by a taxpayer has a unique and separate tax basis
- A taxpayer's "adjusted basis" in property is used to determine taxable gain or loss on the disposition (by trade or sale) of the property
- In the case of cryptocurrency, the taxpayer's adjusted tax basis will generally equal the US dollars value of the cash, property, or services exchanged for the cryptocurrency
 - Cash
 - FMV

Tracing Coin Sales in a Portfolio

- Because cryptocurrency is not currently characterized as a security for tax purposes, the default rule for sales of separate assets is specific identification pursuant to § 1012 and the regulations issued thereunder – tracing each sale to a particular coin and calculating gain based on the tax basis associated with such coin
 - Difficult where multiple purchases/acquisitions are made over time
 - Does provide greater flexibility in terms of minimizing gains (sell high basis first) and losses
 - Consider potential to segregate purchases in separate accounts if taxpayer intends to rely on separate tracing to calculate gains/losses
 - Treas. Reg. § 1.1012-1(c) contains a specific stock rule that defaults to FIFO method where taxpayer fails to specifically identify shares that are sold
- Alternative of applying FIFO, LIFO or average-weighted-basis approach

Character



- Character of any gain or loss from the sale or exchange of virtual currency depends on whether the virtual currency is a capital asset in the hands of the particular taxpayer
- Section 1221 provides that the term “capital asset” means property held by a taxpayer, and then excludes a number of categories, including “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business”

Short-Term vs. Long-Term Capital Gains/Losses

- One-year rule of § 1222:
 - Short term capital gain/loss is triggered with respect to the disposition of any capital asset held by the taxpayer for one year or less
 - Long term capital gain/loss is triggered with respect to the disposition of any capital asset held by the taxpayer for greater than one year
- Wash Sales Rule of § 1091
 - Prohibit a taxpayer from claiming a § 165 loss on the sale or exchange of a security where the taxpayer disposes of a security at a loss and then buys a “substantially identical” security 30 days prior to, or 30 days after, the loss-triggering disposition.
 - Based on the current IRS position regarding the characterization of cryptocurrency, the § 1091 wash sales rules may not apply (at least with respect to convertible cryptocurrencies)

Section 1031 Like-Kind Exchanges

- Section 1031 permits taxpayers to exchange property for “like kind” property within 180 days without triggering a taxable event
 - Potential arguments that pre-January 1, 2018, exchanges of one type cryptocurrency for a different cryptocurrency qualify as a “like kind” exchange subject to § 1031
 - “Properties are of like-kind, if they are of the same nature or character, even if they differ in grade or quality. Personal properties of a like class are like-kind properties. However, livestock of different sexes are not like-kind properties. Also, personal property used predominantly in the United States and personal property used predominantly outside the United States are not like-kind properties.” www.irs.gov
 - IRS Form 8824
- Tax Reform amended § 1031 to limit its application to exchanges of real property – effective for exchanges completed on or after January 1, 2018

TAX IMPLICATIONS OF CRYPTOCURRENCY “HARD FORKS”

What Is a “Hard Fork”?

- What is a cryptocurrency “hard fork”?
 - Also referred to as “chain splits” and “coin splits”
 - A change to the software of the digital currency that creates two separate versions of the blockchain with a shared history
 - When a hard fork occurs, a new “branch” splits from the original ledger and thereafter the two ledgers (the original and new) are separately maintained
 - After a hard fork, the owner of the cryptocurrency retains his ownership of the original coin and obtains the right to separately use the new forked coin



What Is a “Hard Fork”?

- Why are there hard forks?
 - Multiple range of reasons
 - In 2016, the Ethereum blockchain was split into two, Classic Ethereum and Ethereum in response to a hacking attack that impacted the original ledger
 - In 2017, Bitcoin split into Bitcoin (BTC) and Bitcoin Cash (BCH)
 - Other examples in 2017 include Bitcoin Gold, Bitcoin Diamond, Superbitcoin, Bitcoin Hot, and Lightning Bitcoin



Hard Fork Tax Issues

- ABA Comment Letter (March 19, 2018) raised a number of tax issues associated with cryptocurrency hard forks
 - Are hard forks a tax-realization event?
 - Timing of realization
 - Basis issues



Is a Hard Fork a Realization Event?

- ABA comment letter concludes “a reasonable argument can be made that the receipt of a forked coin resulting from a Hard Fork constitutes a realization [taxable] event.”
- Not all tax advisors agree with the ABA’s conclusion regarding realization
 - Argument that the potential for hard forks are inherent in cryptocurrency assets and the buyer acquires that right/attribute of a hard fork when the coin is first sold.
 - The receipt of the hard forked coin is not a realization event – only the sale of such coin triggers a taxable event.



Hard Fork Tax Issues

- The timing of realization
 - ABA asserts that the timing of realization should occur when the taxpayer has the right to secure the forked coin (the taxpayer can't delay realization by failing to take action to download the new forked coin – constructive receipt)
- Amount realized
 - ABA notes that the amount realized is the FMV of the forked coin when received by the taxpayer
 - Acknowledges that determining FMV is not always easy
- Basis of original and forked coins
 - Split proportionately based on the relative FMVs of the two coins at the time of the hard fork

Hard Fork Tax Issues

- ABA safe harbor proposal. ABA suggested that the IRS should issue guidance that:
 - Recognizes that a hard fork is a taxable event for the owner of the original coin
 - The deemed value of the forked coin at the time of realization event is zero, as is the tax basis in the forked coin
 - The holding period of the forked coin would start on the day of the hard fork
 - Taxpayers electing the safe harbor treatment would be required to disclose the position on their tax returns
 - The Service will not assert that any taxpayer availing himself of the safe harbor understated his taxes with respect to the hard fork event (any subsequent sale of the forked coin is not covered by the safe harbor)

CONSIDERATIONS FOR INITIAL COIN OFFERINGS

Initial Coin Offerings

- Initial Coin Offerings (ICO)
 - Explosive growth in 2017 and continuing into 2018
 - Pace of 100+ ICOs per month during 2018
 - An ICO involves the issuance of a newly generated cryptocurrency (frequently referred to as a “token”) that runs on blockchain
 - Disruptive challenge to VC and angel investors
 - Tokens are typically issued in exchange for a fiat currency (e.g., \$ or €) or other cryptocurrencies that have an established market
- Types of Tokens
 - “Utility tokens” provide the holder with access to the blockchain platform, products, and/or services
 - “Security tokens” provide the holder with equity or debt-like rights to an entity



Typical Initial Coin Offering Features

- A process of raising funds from investors – also referred to as “token crowdsale”
- Innovative crowdfunding mechanism mostly used by blockchain technology and fintech startups
- A mixture of equity offering and donation
 - tokens instead of shares (no corporate rights)
 - white paper instead of prospectus
 - little to no government agency (SEC or central bank) involved
 - timing from several days to several seconds
- Tokens are sold for cryptocurrency (usually, Ether or Bitcoin)

Why Participate in an Initial Coin Offering

- For coin (token) issuers
 - raise money from investors (or product users)
 - increase project visibility and attract new users
 - serve the community
- For investors, the benefits depend on the token type
 - use acquired tokens to access the services of the coin issuers (user tokens or appcoins)
 - share revenues of the coin issuer (equity tokens) and control the activities through a decentralized autonomous organization (DAO)
 - get interest on the amounts of tokens (debt tokens)
 - sell tokens when token value increases
- There could also be a combination of the above

Recent Initial Coin Offerings - Snapshot



- Golem – P2P cloud computing solution – raised USD 8.6 million in few hours



- Bancor – ecosystem for creating interchangeable tokens – raised USD 153 million in 2.5 hours



- Gnosis – Ethereum based forecasting tool – raised USD 12 million in 10 minutes



- TenX – solution for spending cryptocurrencies in real world – raised USD 34 million in 7 minutes



- Brave – web browser – raised USD 35 million in **24 seconds!**

Initial Coin Offerings – Pros and Cons

Pros	Cons
Unregulated and cost-efficient (starting to change)	No protection against fraudulent issuers; lack of recourse
No detailed preparation and paperwork	Risks have to be assessed by investors
Lightning-fast fundraising	Quick fundraising timeline – blink and you miss it
Secure (anonymous) payment for tokens with cryptocurrency	Necessity to acquire cryptocurrency in advance
Rapid tokens value growth	Risks of market overheat
Issuers have no restraints imposed by investors	No shareholder control over the company

Initial Coin Offerings – Risks for Investors

- Not all coin issuers are able to provide investors with a justified white paper outlining project prospects
- Unregulated process - no legal protection for investor's rights
- No guarantee against fraud and guaranteed return of investments
- Coin issuers/investors could remain unknown AML issues
- No control over the target company (coin issuer)

Initial Coin Offerings – Tax Considerations

- The taxation of ICOs for the issuing entity is unclear, and until further guidance is issued by the IRS, dependent on a facts-and-circumstances analysis in each instance
 - Each ICO tends to be different, which makes tax generalizations risky
- Pursuant to Notice 2014-21, cryptocurrency is property. The general tax rule is that the receipt of cash or other valuable property in exchange for the sale of a token by a taxpayer is taxable.
 - Receipt of ICO proceeds are treated as a sale of property in which the issuer has zero-tax basis
 - All taxable gain realized in the year of the ICO
 - Unlikely to qualify as a capital asset, as such all proceeds likely ordinary income

Initial Coin Offerings – Tax Considerations

- Can a security token be structured to qualify as stock or debt?
 - Unclear – turns on application of debt/equity analysis
 - Section 1032(a) generally provides that no taxable gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation
 - The issuance of a debt instrument is not a taxable event
 - Other theories? Arguments that a token issuance is analogous to a PSL?
 - PLR 201722004 (ruling sale of redeemable personal seat licenses (PSLs) by a professional sports team did not result in immediate income for the team)
- Characterization of utility tokens?
 - Unlikely to qualify as a stock or debt for tax purposes
 - PSL arguments?

Initial Coin Offerings – Tax Considerations

- Tax Implications for Purchasers
 - Purchase of tokens with US dollars is not a taxable event for a US taxpayer
 - Purchase of tokens with cryptocurrency taxable event with gain/loss measured based on the purchaser's tax basis (or bases) in the cryptocurrency used in the exchange
 - Consider § 1031 for pre-2018 transactions
 - Taxpayer's basis in the newly acquired token will be the purchase price (if fiat currency used) or FMV of property exchanged
 - Later use of the token by the purchaser to acquire other property or a service would separately give rise to a taxable event (triggering gain or loss based on the AB of the cryptocurrency compared to the FMV of the cryptocurrency)

Initial Coin Offerings – Tax Considerations

- Simple Agreement for Future Tokens (or Equity) (SAFTE)
 - Used by numerous companies to raise funds prior to a token offering
 - Based on the Y Combinator model Simple Agreement for Future Equity (SAFE)
 - Intended tax characterization is to defer the recognition of taxable income with respect to the funds paid to SAFTE issuer until the time the tokens are issued (presumably in a different tax year)
 - Intended deferral is not certain; depends on terms of SAFTE agreement

SELECT US INTERNATIONAL TAX RULES AND CRYPTOCURRENCY

U.S. International Rules and Cryptocurrencies

- As demonstrated by Notice 2014-21, cryptocurrencies are subject to the full range of US federal income tax laws
- This general approach to the application of the US tax laws does not change in the international setting
- The following slides provide a couple of examples where the US international provisions could come into play with cryptocurrency transactions
 - These slides are not intended to provide a comprehensive discussion of the US international tax considerations with cryptocurrency transactions

Subpart F and GILTI

- Buying/selling cryptocurrencies and ICOs carried out by foreign corporations raise important US tax considerations for US shareholder(s)
- Need to manage the US Subpart F anti-deferral provisions and the new § 951A tax on Global Intangible Low Taxed Income (GILTI)
 - Applicable to “US shareholders” of controlled foreign corporations (CFCs)
 - US shareholder defined as shareholder who owns, or is considered as owning, stock representing 10% or more vote or value of the foreign corporation
 - CFC status triggered where U.S. shareholders own >50% of the vote or value of the foreign corporation
 - Established case law addressing substance over form in testing US shareholder and CFC status – consider in context of “cutting edge” structures to avoid CFC and/or US shareholder status (e.g., “Cayman Foundation” structures)
- Consider PFIC for shareholders not subject to CFC/GILTI provisions

Section 864(b) Safe Harbor?

- Section 864(b) provides foreign investors an important exception from the definition of “US trade or business” where investment activities are performed in the US
 - Exception applies where the activities are limited to trading in stocks, securities, and commodities on the taxpayer’s own account
 - Important exception for situations where a foreign investor is a partner in an investment partnership with operations in the US
- Because cryptocurrency is currently not considered a stock, security, or commodity for US federal income tax purposes – at least with respect to “convertible” cryptocurrencies – a foreign investor with exposure to cryptocurrency through an investment partnership with operations in the US could be subject to US taxation on gains realized (and filing obligations)

Cross-Border Mining Pools



- Is a mining pool characterized as a partnership for US tax purposes?
- If the mining pool involves participants in multiple jurisdictions:
 - Do pool participants trigger “Permanent Establishments” in one or more jurisdictions for the joint venture?
 - Is there a withholding obligation when the proceeds are distributed to the pool participants?

Cryptocurrency Globally



- Non-US: Regulation widely disparate
 - China and South Korea banned initial coin offerings
 - Bangladesh, Bolivia, Ecuador, and Kyrgyzstan made cryptocurrencies illegal in all or some respects
 - Australia and Japan have recognized cryptocurrency as legal tender
 - Russia's central bank is in the development phase of cryptocurrency creation and China testing a cryptocurrency
- Worldwide: Multiple levels of theft to be regulated
 - Highest levels: e.g., hacker exploited loophole in code that allowed one-third of ethereum funds to be stolen (June 2016)
 - More basic levels: personal computers may be used to mine crypto coins without owner's knowledge

INTERPLAY BETWEEN CRYPTOCURRENCY & U.S. SECURITIES LAWS

Initial Coin Offerings - US Securities Laws Issues

- Are coins or tokens “securities”?

According to the SEC, “it depends”:

- “Depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities. If they are securities, the offer and sale of these virtual coins or tokens in an ICO are subject to the federal securities laws.”

– *Report of Investigation re: The DAO (July 25, 2017)*

A contrasting view:

- “ICOs represent the most pervasive, open and notorious violation of federal securities laws since the Code of Hammurabi.”

– *Former SEC Commissioner Joseph Grundfest
(quoted in N.Y. Times, Nov. 26, 2017)*

Initial Coin Offerings - U.S. Securities Laws Issues (cont'd)

When might virtual currency be a security?

- Federal securities laws are designed “to regulate investments, in whatever form they are made and by whatever name they are called.” The definition of “security” is broad enough “to encompass ***virtually any instrument that might be sold as an investment.***”
 - *SEC v. Edwards*, 540 U.S. 389, 393 (2004); 15 U.S.C. § 77b(a)(1)
- SEC’s July 2017 DAO Report confirms the prevailing view that the test of an “investment contract” is central. An “investment contract” is a contract, transaction, arrangement, or scheme (need not be a formal contract) in which:
 - 1) a person invests money,
 - 2) in a common enterprise, and
 - 3) with expectation of profit from the efforts of others.
 - *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946)

Initial Coin Offerings - U.S. Securities Laws Issues (cont'd)

Investment contract application to ICOs

- The DAO case: ETH used to buy DAO tokens, which conferred voting and ownership rights and profit interests in projects to be undertaken by the DAO.
 - (i) investment; (ii) common enterprise; (iii) profit expectation; and (iv) from the managerial efforts of others.
- Depending on underlying investment(s), the token issuer also may be an “investment company” under the 1940 Act.
- In a “decentralized” organization, who is the issuer?
 - 1933 Act: “Person” includes “unincorporated organization”
 - 1940 Act “Company” includes “organized group of persons whether incorporated or not”

Initial Coin Offerings – U.S. Securities Act of 1933

Securities registration requirement

- To be lawfully offered or sold, a security must be registered with the SEC, or qualify for an exemption from registration (under the Securities Act of 1933).
 - Registration is a multi-step, expensive process.
 - Common exemptions include sales limited to institutional investors and sales in private offerings to “accredited investors” (special requirements).
 - ***It may be difficult to manage a token offering as a non-public offering.***
- Registration or exemption requirement applies to **every** sale, including secondary market resales by initial purchaser.
- Securities registration noncompliance gives rise to an onerous **rescission** remedy under federal law and the laws of most states.

Initial Coin Offerings – Other U.S. Securities Laws

Securities fraud statutes apply

- Any material misrepresentation or omission in connection with an offer, sale, or resale may give rise to liability.
- Laws governing initial offerings and some state statutes allow remedies without intentional fraud; due care is only a defense.
- SEC warning re celebrity ICO endorsements (failure to disclose compensation).
- Several SEC/USAO actions and several putative securities class actions filed within the last few months re particular ICOs.

Broker-Dealer Registration Requirements

- Anyone in the business of buying or selling securities (a dealer) or effecting securities transactions for others (a broker), unless exempt, must register with the SEC and state securities regulators.

Exchange Registration

- Any organization or group that “maintains or provides a market place or facilities for bringing together purchasers and sellers of securities” is subject to SEC regulation as a national securities exchange.

Initial Coin Offerings – U.S. Investment Company Act

Investment Company Act of 1940

- A token issuer that, in turn, invests in a variety of other enterprises, as was the case with the DAO, may be an “investment company” under the 1940 Act.
- Since operation as an investment company is likely not feasible, such an issuer likely would have to rely on an exclusion:
 - Section 3(c)(1) (limited to 100 beneficial owners),
 - Section 3(c)(7) (limited to “qualified purchasers”), or
 - No public offering.
- Violations subject to civil and criminal enforcement.
 - Section 47 renders contracts in contravention of the 1940 Act voidable by a court.

INVESTOR SIDE PROTECTIONS IN INVESTMENT FUNDS

Cryptocurrencies – LP Side Protections

Ventures funds are starting to invest in Cryptocurrencies

- The creation of “Digital Assets”
- Assess risk profile
 - Diligence discussion of extent to which investments will be made:
 - Investing in currency (obtain digital asset);
 - Investing in token (ICOs); or
 - Investing in companies engaged in cryptocurrency, blockchain or Fintech spaces.
 - Contractual restriction in the fund’s governing documents.
 - Purpose of investment: to obtain digital asset or to provide funding to a startup?
 - Type of Cryptocurrency Investing in: seek restriction or verification of rating?
 - All the risks of making such investments passed onto LPs.

Cryptocurrencies – LP Side Protections

Valuations

- How are such assets valued?
 - Investing in currency (obtain digital asset);
 - Investing in token (ICOs); or
 - Investing in companies engaged in cryptocurrency, blockchain or Fintech spaces.
- Is there any third-party oversight of the valuation?
- How to counter flexibility to choose valuation date?

Cryptocurrencies – LP Side Protections

Distributions

- Distributions made in kind?
- When are such in-kind distributions permitted?
- Liquidity issues
 - Investing in currency (obtain digital asset);
 - Investing in token (ICOs); or
 - Investing in companies engaged in cryptocurrency, blockchain, or Fintech spaces.

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Sarah-Jane Morin focuses her practice on representation of public and private companies, private equity funds, venture capital funds, real estate funds, portfolio companies, and real estate investment trusts 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. Additionally, she advises on international tax issues, including the tax aspects of offshore vehicles (CFC/PFIC regimes), anti-deferral rules (Subpart F), withholding, cost sharing, and transfer pricing.

Sarah-Jane advises on the tax aspects of non-profit entity formation and operation, with an emphasis on IRC Section 501(c)(3). She has worked with a number of tax-exempt investors in their LP investments, as well as for clients in their applications for tax exemption.

Prior to joining Morgan Lewis, Sarah-Jane was a senior director in Oracle's tax planning department. Prior to joining Oracle, she was an associate at a multinational law firm.



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Miranda Lindl O'Connell works primarily on the structuring, formation, governance of, and investment in US domestic and international private investment funds. Specifically, Miranda represents clients in the formation of funds of funds, funds sponsored by 501(c)(3) entities, corporate governance funds, venture capital funds, real estate funds, co-investment funds, and private equity funds. She advises funds of funds, employee benefit plans, and other institutional investors regarding investment in and the secondary sale of interests in private investment funds (individually or as a portfolio).

The American Bar Association presented Miranda with its Outstanding Volunteer in Public Service Award for her work at the Homeless Advocacy Project.

While in law school, Miranda served as an extern for Judge John T. Noonan of the US Court of Appeals for the Ninth Circuit. Prior to law school, she worked as the race director for the San Francisco Marathon.

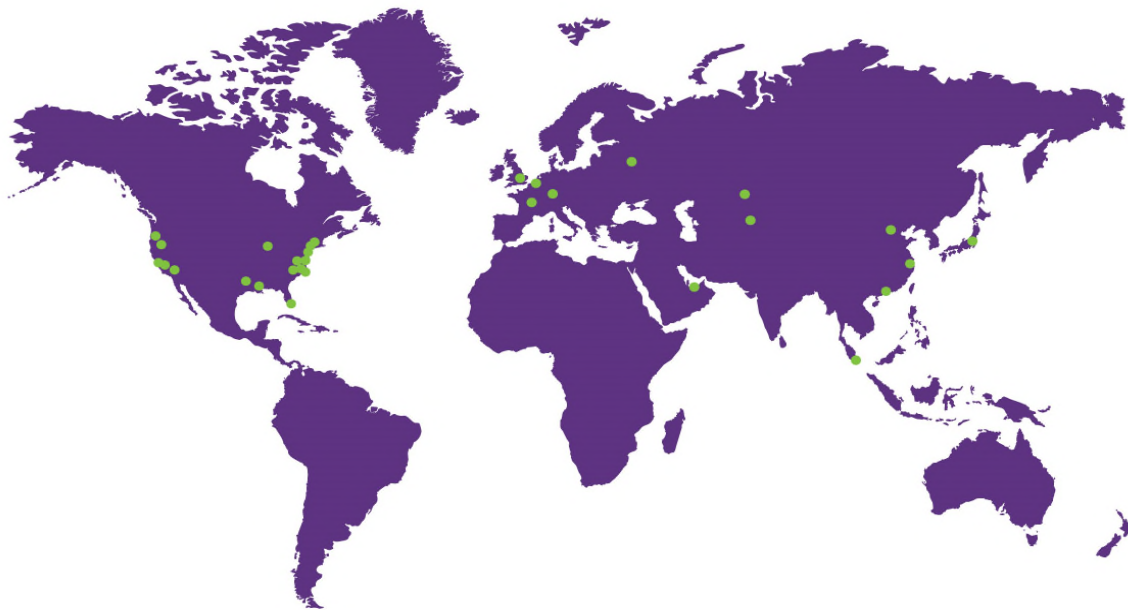


Our Global Reach

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