

# *The Lawyer's Guide to Cryptocurrency: Ethical, Tax, and Reporting Issues with the Receipt of Cryptocurrency as Payment for Legal Services*

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## **I. Introduction**

The cryptocurrency (“crypto”) economy appears here to stay. Notwithstanding the recent “crypto winter,” the use of, and trading in, bitcoin and other cryptocurrencies has exploded over the last several years. Once viewed as mysterious, fringe operators regulated to the web, cryptocurrency exchanges have become major actors in the global economy, with the largest, such as Coinbase, making public offerings. Major financial institutions have been scrambling to get in on the act. In April, financial services giant Fidelity introduced Bitcoin as a retirement investment option in employee benefit plans.<sup>1</sup> And as recently as last month, Mastercard announced that it will be launching a cryptocurrency payments card that will permit users to process credit card transactions using bitcoin and several other cryptocurrencies.<sup>2</sup>

As cryptocurrency has become more widely used across the global economy, the number of clients seeking to use it to pay for legal services is increasingly dramatically, forcing many professionals to become familiar with this new medium of commerce. At the same time, while cryptocurrency possesses many similar traits to fiat currency, it is still a very different animal from its more tangible relative, carrying with it very different tax, reporting, and ethical obligations. This article endeavors to familiarize counsel with some of the unique issues one can expect

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to encounter when entering legal services arrangements where payment is made using cryptocurrency.

## II. What Is Cryptocurrency and How Is It Transacted?

Cryptocurrency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value.<sup>3</sup> The most well-known and widely used cryptocurrency is bitcoin. Unlike fiat currencies, which are backed by governments and are tangible, cryptocurrencies exist exclusively in the digital world. They are recorded on a blockchain, a decentralized, virtual ledger of all peer-to-peer transactions in a particular cryptocurrency. Most commonly, cryptocurrency coins are stored using a digital “wallet.” The owner of the cryptocurrency has a public key, which resembles an account number, and a private key, similar to a password, which is used to transfer cryptocurrency to a recipient. To transfer cryptocurrency, the recipient provides the sender with her public key, which the sender uses to transmit the cryptocurrency from her digital wallet, which she accesses using her private key.

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The cryptocurrency market has also seen the emergence of Bitcoin Merchant Service Providers (“BMSP”). For a commission, these third-party providers will receive cryptocurrency from the payor/client and pay their customer in the equivalent in U.S. dollars. While the use of a BMSP may provide a convenient way to avoid many of the administrative headaches associated with transacting in cryptocurrency, their usage does not relieve the recipient lawyer of the tax, reporting, and ethical obligations associated with the receipt of cryptocurrency.

## III. Taxation of Cryptocurrency

Among the first things that a prospective recipient of cryptocurrency must understand is that cryptocurrency is treated differently than fiat currency for tax purposes. As set forth in Notice 2014-21, virtual currency is treated as property for tax purposes.<sup>4</sup> Accordingly, taxpayers must recognize gain or loss whenever cryptocurrency is sold or used to purchase goods or services, with the gain or loss treated as a capital transaction.<sup>5</sup> Gains on virtual currency held less than one year would therefore be treated as short-term capital gain, and taxed at ordinary rates, with virtual coins held more than one year taxed at capital gain rates. Basis in the virtual currency is the fair market value of the currency (in U.S. dollars) on the date it was initially received.

When a lawyer/professional and a client agree that the client will pay for services in virtual currency, they should appreciate that there will be tax consequences for both of them. The receipt of cryptocurrency in exchange for services is, of course, taxed as ordinary income to the lawyer.<sup>6</sup> Meanwhile, the client will have a gain or loss (either capital or ordinary) when the transaction is consummated. And even if the lawyer intends to convert the virtual currency to fiat currency soon after receipt, such exchange will still constitute a taxable event, especially given the rapid and significant price fluctuations in virtual currency.

## IV. Reporting of Cryptocurrency

In addition to the tax implications of accepting cryptocurrency for legal services, transacting in cryptocurrency carries with it ever-increasing reporting obligations. Put simply, “the regulatory scheme for cryptocurrency is unclear and state and federal agencies are largely still determining how best to regulate cryptocurrency.”<sup>7</sup>

At its inception, part of the allure of cryptocurrency to many was the fact that cryptocurrency transactions took place free of government regulation. Not surprisingly, this made cryptocurrency transactions an attractive means of conducting business for cyber criminals and money launderers.<sup>8</sup> For its part, the U.S. government has responded by extending its anti-money laundering and financial reporting regulations to cryptocurrency transactions.<sup>9</sup>

While much of the expanding regulatory environment has been focused on cryptocurrency exchanges and financial institutions, recent enactments affect individuals and businesses such as law firms. Most significantly, beginning

in 2023, all businesses, including law firms and accounting firms, who receive more than \$10,000 worth of cryptocurrency in a single or related transaction will be required to report the receipt of such cryptocurrency on Form 8300 filed with the IRS.<sup>10</sup>

The Form 8300 filing requirement is not new. For decades, as part of the Bank Secrecy Act, businesses were required to report the receipt of \$10,000 or more in cash using Form 8300. However, the Infrastructure Investment and Jobs Act of 2021 extended the filing requirement to cryptocurrency by broadening the definition of “cash” to include “any digital representation of value,” such as bitcoin.<sup>11</sup> The impact of this change on the reporting requirements for business has potentially huge significance. While the use of cash as payment for services has been in decline for years, the use of cryptocurrency as a form of payment is on the rise, meaning the instances in which the Form 8300 requirement will be triggered will be ever increasing. Completing a Form 8300 form for a cryptocurrency transaction also will likely be more challenging and tedious since, for instance, it will require valuing the cryptocurrency received in U.S. dollars.

The consequences for non-compliance with the requirement to file Form 8300 are also significant. A non-willful failure to file Form 8300 carries penalties of \$250 per violation (up to a maximum of \$3 million).<sup>12</sup> The willful failure to file Form 8300 is a crime, punishable by up to five years imprisonment with monetary penalties of the greater of \$25,000 or the amount received in the transaction (up to a maximum of \$100,000).<sup>13</sup>

U.S. regulators are also looking to bring cryptocurrency within the regulatory regime governing the reporting of offshore accounts. In December 2020, FinCEN, the agency that oversees compliance with foreign account reporting, announced that it intends to propose amendments to the regulations governing the filing of reports of foreign accounts (“FBAR”) to include virtual currency as a type of reportable account.<sup>14</sup>

## V. Ethical Rules Governing the Receipt of Cryptocurrency

Ethical bodies also are currently grappling with how to treat payment arrangements involving cryptocurrency. All seem to agree there is nothing inherently unethical with accepting cryptocurrency in exchange for legal services. Nevertheless, fee arrangements using cryptocurrency present issues that ordinary transactions in fiat currency do not.

The few state bar associations that have tackled the issue thus far focused mainly on rules governing unreasonable fees and engaging in a business transaction with a client. Both sets of concerns center around the volatility of cryptocurrency. For instance, in the first ethical rule issued on the subject, the Nevada state bar directed attorneys to immediately convert cryptocurrency received as payment into fiat currency. Invoking the state bar equivalent of ABA Model Rule 1.5, governing the charging of unreasonable fees, the motivation for the rule was to prevent lawyers from receiving a windfall if the value of the cryptocurrency received were to skyrocket.

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Nevada’s bright line approach would seem unnecessary in instances where cryptocurrency is tendered as payment for legal services already rendered. After all, the value of the cryptocurrency tendered as payment can be measured as of the time of payment for purposes of determining the reasonableness of the fee.<sup>15</sup> Any risk associated with the volatility of the currency would transfer to the attorney at the time of payment. The issue becomes more complicated when it comes to retainer arrangements, pursuant to which the lawyer is holding funds in trust for the client to be applied toward future legal services. The North Carolina bar has addressed this issue by prohibiting lawyers from accepting cryptocurrency as a retainer payment or in other circumstances where the lawyer holds funds in trust for a client, but not when tendered as payment for legal services rendered.<sup>16</sup>

Both the New York and North Carolina bar associations treat payments in cryptocurrency as a business transaction for purposes of their equivalents to ABA Model Rule 1.8, although New York mandates compliance with Rule 1.8 only where terms of the lawyer–client agreement specify cryptocurrency is the sole method of payment.<sup>17</sup> Treating payment in cryptocurrency as a business transaction between the lawyer and client imposes significant responsibilities upon the lawyer for what is otherwise a simple barter transaction for legal services. For instance, under

ABA Model Rule 1.8, a lawyer may not enter into a business transaction with a client unless the transaction and the lawyer's interest in it are fully disclosed to the client in writing, the client is advised in writing of the desirability and opportunity of securing legal counsel, and the client gives informed written consent to the transaction. This begs the question of what constitutes full disclosure in a cryptocurrency transaction for legal services. For instance, is the lawyer obligated to inform the client that payment in cryptocurrency will be a taxable event? Should the client be encouraged to obtain tax advice prior to engaging in the transaction?

Another issue flagged by state ethical bodies relates to security. Digital wallets carry with them different security risks than traditional banks, and are not Federal Deposit Insurance Corporation ("FDIC") insured. This especially poses an issue in instances where the lawyer holds cryptocurrency in escrow, as a retainer or for other reasons. The District of Columbia addressed this issue, requiring lawyers to take steps to safeguard the digital assets involved in cryptocurrency transactions with clients that are disclosed to the clients.<sup>18</sup>

The diverse views expressed by the limited number of ethical bodies that have weighed in on this subject

evidences that state bar associations are struggling as much as anyone else to adapt to the new landscape presented by cryptocurrency. In such a climate, the best way for a lawyer to protect herself is by drafting a detailed engagement letter that discloses as much information as possible about payment arrangements using cryptocurrency. At a minimum, the agreement should include information on how and when cryptocurrency payments will be valued, how they will be processed, and the Firm's reporting obligations for such payments (*e.g.*, to file Form 8300). If the lawyer/firm intends to use a BMSP to process the transaction, that fact should be disclosed as well, including who is responsible for the BSMP's fees. It also may behoove the lawyer to disclose in the agreement that the payment in cryptocurrency may be a taxable event to the client.

## VI. Conclusion

Like it or not, in the coming years more and more lawyers almost certainly will be encountering clients seeking to pay them using cryptocurrency. By familiarizing themselves with the regulatory and ethical rules surrounding cryptocurrency, lawyers can equip themselves to bravely enter the crypto-economy.

### ENDNOTES

<sup>1</sup> CBS News, "Fidelity to Let 401(k) Customers Add Bitcoin to Their Retirement Accounts," April 27, 2022, available at [www.cbsnews.com/news/fidelity-investments-bitcoin-401k-cryptocurrency-retirement/](http://www.cbsnews.com/news/fidelity-investments-bitcoin-401k-cryptocurrency-retirement/).

<sup>2</sup> Forbes, "The Future Is Here—Visa, Mastercard and Binance Are Suddenly Making Bitcoin, Ethereum, XRP, Solana, Cardano And Tether Payments A Reality Despite Price Crash," Aug. 26, 2022, available at [www.forbes.com/sites/billybambrough/2022/08/25/the-future-is-here-visa-mastercard-and-binance-are-suddenly-making-bitcoin-ethereum-xrp-solana-cardano-and-tether-payments-a-reality-despite-price-crash/?sh=650bd3221ae0](http://www.forbes.com/sites/billybambrough/2022/08/25/the-future-is-here-visa-mastercard-and-binance-are-suddenly-making-bitcoin-ethereum-xrp-solana-cardano-and-tether-payments-a-reality-despite-price-crash/?sh=650bd3221ae0).

<sup>3</sup> Notice 2014-21, IRB 2014-16, 938.

<sup>4</sup> *Id.*

<sup>5</sup> Code Sec. 1221(a).

<sup>6</sup> Code Sec. 61(a).

<sup>7</sup> Association of the Bar of the City of New York, Comm. on Prof. Ethics, Formal Op. 2019-5, "Requiring Cryptocurrency in Payment for Legal Services."

<sup>8</sup> Reuters, "Crypto money laundering rises 30% in 2021—Chainalysis," available at [www.reuters.com/technology/crypto-money-laundering-rises-30-2021-chainalysis-2022-01-26/#:~:text=NEW%20YORK%2C%20Jan%2026%20\(Reuters,firm%20Chainalysis%20released%20on%20Wednesday](http://www.reuters.com/technology/crypto-money-laundering-rises-30-2021-chainalysis-2022-01-26/#:~:text=NEW%20YORK%2C%20Jan%2026%20(Reuters,firm%20Chainalysis%20released%20on%20Wednesday).

<sup>9</sup> Don Fort, Christopher M. Ferguson and Olivia Renensland, "AMLA 2020: Sweeping New ALMA Laws Have Broad Impacts on All Financial Crimes," American Bar Ass'n White Collar Crime Committee Newsletter, Winter/Spring 2021, available at [www.americanbar.org/content/dam/aba/publications/criminaljustice/2021/aml2020.pdf](http://www.americanbar.org/content/dam/aba/publications/criminaljustice/2021/aml2020.pdf).

<sup>10</sup> Pub. L. 117-58; Matthew Erksine, "Reporting Requirements for Cryptocurrencies and NFTs Begin in 2023" *Forbes*, Jan. 6, 2022.

<sup>11</sup> Pub. L. 117-58; Code Sec. 6050I.

<sup>12</sup> Code Secs. 6721, 6722.

<sup>13</sup> Code Sec. 7203.

<sup>14</sup> See FinCEN Notice 2020-2. See also 31 CFR 1010.350(c).

<sup>15</sup> Nika Gigashvili, "The Ethics of Accepting Cryptocurrency as a Payment," [www.americanbar.org](http://www.americanbar.org) (Nov. 21, 2019), [www.americanbar.org/groups/litigation/committees/jiop/articles/2019/fall2019-ethics-of-accepting-cryptocurrency-as-payment](http://www.americanbar.org/groups/litigation/committees/jiop/articles/2019/fall2019-ethics-of-accepting-cryptocurrency-as-payment).

<sup>16</sup> North Carolina State Bar 2019 Formal Ethics Op. 5.

<sup>17</sup> *Id.*; NYCBA Formal Op. 2019-5.

<sup>18</sup> District of Columbia Ethics Op. 378.

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