

Feds Taking an Interest in Virtual Currencies

August 16, 2013 - If you don't know what "virtual currency" is, that's probably because they have limited popularity. The most popular one is called Bitcoin, but there are a wide variety of others that are also gaining in popularity. These currencies can be converted to US dollars and used to purchase a wide variety of goods and services online. But the thing that seems to worry the government the most is that some of them - Bitcoin included - are completely anonymous. Because there is no need to have a bank involved when acquiring or spending virtual money, there is absolutely no reporting to the IRS or law enforcement. And that now has the attention of both Congress and some state lawmakers.

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Within the past week, two new investigations have been launched regarding virtual currency. One by the State of New York and the other by a Senate committee that also oversees the Department of Homeland Security.

Both investigations are under the guise of preventing money laundering and criminal transactions. But both are also closely looking at ways to regulate these types of currencies with an eye on finding a way to levy taxes against them.

The New York investigation appears to be looking specifically at Bitcoin and is being headed up by the state's top financial regulator; Benjamin Lawsky. Lawsky has now issued 22 separate subpoenas to companies involved with Bitcoin.

The Senate investigation is more broad brushed but as one of the internet's largest virtual currencies, Bitcoin is certain to receive significant scrutiny.

At present, there is no barrier to setting up a business that uses Bitcoin or other similar currencies. As of the time of this writing, one Bitcoin is exchangeable for \$110.20 (the current exchange rate).

In all likelihood, any government regulation that comes out of these investigations would have to focus on regulating the businesses that use virtual currencies, rather than on regulating the currencies themselves. The reason for this is that Bitcoin and many others are decentralized - meaning there is no central issuing authority such as a bank or treasury - and that they are specifically designed to be anonymous.

Since these currencies only exist in cyberspace, national borders don't really mean too much. That makes it very difficult for any government to stop their use. It also makes them attractive tax havens. Forbes has run a number of articles over

the past two years on the implications of virtual currency for purposes of tax evasion. So have a variety of other well-known and respected publications.

Since governments are not involved in issuing virtual currencies, they may provide those worried about government deficit spending and financial mismanagement with a way to legitimately shield some of their assets. But that ability does come with some risk.

Bitcoin limits the amount of currency in circulation based on a computer algorithm. Since just about anything that is computer based can be hacked, there is a real risk that someone could eventually crack the algorithm and start producing counterfeit currency.

Another concern is that the value of virtual currencies could be manipulated by currency traders looking for short term profits. But those individual risks are probably of much less concern to the government than the implications of a competing monetary system. Money is only valuable if people think it is valuable. If large numbers of consumers around the world begin using anonymous virtual currencies that governments have little visibility to or ability to control, it could force governments around the globe to change the way that they collect taxes. It could also force significant changes in government spending. These new investigations are likely the first in the United States towards finding a way to regulate the virtual currency market.

byJim Malmberg

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