

## Issues Nonprofits Should Consider Before Accepting Cryptocurrency Donations

Many nonprofits are considering whether to start accepting cryptocurrency contributions. **Cryptocurrency** (sometimes called “digital currency” or “virtual currency”) is a method of exchanging value through the use of blockchain technology. **Blockchain** is essentially a decentralized, electronic ledger, which allows all users to make entries and to verify the accuracy of the entries in the ledger.

There are many different types of cryptocurrencies, with Bitcoin being the first and most famous. There are also many different government agencies that are starting to regulate these types of currency. This legal alert identifies legal issues nonprofits should explore before deciding whether to accept donations of one or more forms of cryptocurrency.

### 1. How is This Type of Cryptocurrency Regulated?

Before accepting cryptocurrency there are some threshold questions a nonprofit should try to answer relating to the regulation of the cryptocurrency and how that might impact your organization. This will help in determining how much risk accepting the cryptocurrency poses to the organization.

- a. Is the product subject to regulation, such as rules designed to protect investors? Regulations can affect the trading of cryptocurrency or provide potential safeguards. Increased regulation or threats of increased regulation could also affect consumer confidence in a cryptocurrency, and thus the currency’s value.
- b. Does the product comply with all applicable regulations?
- c. What legal protections may be available in the event of fraud, a hack, or malware?
- d. If I do have legal rights, can I effectively enforce them, and will there be adequate funds to compensate me if my rights are violated?

### 2. Should we hold or invest the donation?

Nonprofit organizations formed in New York are required by law to follow certain standards and take certain factors into account in deciding how to manage and invest institutional funds.<sup>i</sup> A New York nonprofit should follow its investment policy in deciding whether and when to convert a cryptocurrency donation to cash.<sup>ii</sup> Relevant considerations may include:

- a. cryptocurrency is not federally insured;
- b. the value of cryptocurrencies can fluctuate wildly;
- c. some cryptocurrencies are subject to restrictions on resale, and the reseller may have to pay related costs.

### **3. What digital currency exchange should we work with?**

A nonprofit may need to work with a digital currency exchange to process a cryptocurrency donation, or to convert it into cash. When deciding which platform to work with, a nonprofit should consider:

- a. how to minimize service fees – some platforms process donations for free for 501(c)(3) organizations;
- b. what protections the platform offers regarding the privacy of donor information and of your organization’s information;
- c. whether the platform complies with money laundering rules and other applicable regulations;<sup>iii</sup>
- d. whether the platform offers a favorable exchange rate; and
- e. whether the platform provides a contract or terms of service that you could rely on in the event of fraud, hacking or malware.

### **4. How should we acknowledge cryptocurrency donations?**

According to the IRS, a charitable nonprofit that receives a cryptocurrency donation should treat it as a noncash contribution.<sup>iv</sup> In any written acknowledgement provided to a donor, the organization can describe the contribution without attempting to place a monetary value on it.<sup>v</sup> A donor may ask your organization to sign a Form 8283 to acknowledge receipt of a cryptocurrency contribution. The IRS has helpfully stated that the nonprofit’s signature on Form 8283 “does not represent concurrence in the appraised value of the cryptocurrency.”<sup>vi</sup>

A charity must file Form 8282 (Donee Information Return) if it sells, exchanges or otherwise disposes of cryptocurrency within three years after the date it originally received the property. The charity must also give the original donor a copy of the form.<sup>vii</sup>

### **5. Donor-imposed Conditions**

Some forms of cryptocurrency allow the donor to use blockchain technology to create “smart contracts,” which automatically impose and monitor compliance with certain restrictions. These could include a requirement that key performance indicators must be met before the donation will be released, or that the donation can be spent only on specific budget lines.<sup>viii</sup> Some considerations for a not-for-profit include:

- a. How can you learn about and evaluate the donor’s conditions?
- b. Is there a written contract with the donor?
- c. Are there “terms and conditions” that are imposed automatically if the recipient clicks an online button?

### **6. Accounting and Security Issues**

Organizations should also be aware that there are some difficulties in security and accounting caused by the ways in which cryptocurrency differs from more traditional forms of currency. In addition to the problems with rapid value fluctuation and digital currency exchanges discussed above, there are potential problems with hackers attacking the virtual

currency security system, fewer protections than a traditional bank if something goes wrong, and potential scams caused by less regulation of cryptocurrency. Additionally, cryptocurrencies are typically held behind a private key which is the only way for someone to access their currency. If the user loses that, then they might not have any way to get to the currency.<sup>ix</sup>

*This alert is meant to provide general information only, not legal advice.*

**Lawyers Alliance staff are available to help qualified nonprofits evaluate the tax and other legal implications of potential cryptocurrency donations. Please contact Senior Policy Counsel Laura Abel at [label@lawyersalliance.org](mailto:label@lawyersalliance.org), (212) 219-1800 x283, or visit [www.lawyersalliance.org](http://www.lawyersalliance.org) for further information.**

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<sup>i</sup> See N.Y. Prudent Management of Institutional Funds Act, N-PCL Art. 5-A.

<sup>ii</sup> *Id* § 552(f).

<sup>iii</sup> For instance, the U.S. Financial Crimes Enforcement Network (FinCEN) has determined that digital currency exchanges are “money services businesses” within the meaning of the Bank Secrecy Act unless they fall within a specific exemption. See FinCEN Guidance 2019-G001, Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies (2019), <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>. Likewise, the NY Department of Financial Services requires anyone engaging in “Virtual Currency Business Activity” to obtain a license in most instances. See 23 NYCRR 200 (“BitLicense Regulation”).

<sup>iv</sup> See IRS Frequently Asked Questions on Virtual Currency Transactions, FAQ #37, <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>

<sup>v</sup> IRS Pub. 1771, Charitable Contributions Substantiation and Disclosure Requirements, <https://www.irs.gov/pub/irs-pdf/p1771.pdf>

<sup>vi</sup> See IRS Frequently Asked Questions on Virtual Currency Transactions, FAQ #36, <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>

<sup>vii</sup> See IRS Frequently Asked Questions on Virtual Currency Transactions, FAQ #37, <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>

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<sup>viii</sup> See Paul Lamb, *Crypto-Philanthropy: How Bitcoin and Blockchain Are Disrupting the World of Giving*, <https://medium.com/@pauljlamb/crypto-philanthropy-how-bitcoin-and-blockchain-are-disrupting-the-philanthropic-sector-80716dc7cb68>.

<sup>ix</sup> The Consumer Financial Protection Bureau has released a consumer alert describing these and other security concerns. See CFPB, *Risks to Consumers Posed by Virtual Currencies* (2014), [https://files.consumerfinance.gov/f/201408\\_cfpb\\_consumer-advisory\\_virtual-currencies.pdf](https://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf).