Legal Alert: Issues Nonprofits Should Consider Before Accepting Cryptocurrency Donations

In light of recent, large donations of cryptocurrency to several nonprofits, 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

   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. Holding and/or Investing 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. A New York nonprofit should follow its investment policy in deciding whether and when to convert a cryptocurrency donation to cash. 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. Relationship with a digital currency exchange

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;
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. Acknowledging donations (donor tax deduction issues)

a. The Internal Revenue Service (IRS) has ruled that cryptocurrency that has an equivalent value in, or acts as a substitute for, real currency is property for federal income tax purposes. Bitcoin is an example of this type of cryptocurrency. The IRS notice provides guidelines for determining the value of such cryptocurrency. Other types of digital assets that use the same “blockchain” technology as cryptocurrency may or may not be covered by the IRS notice, and tax counsel should be consulted before accepting such a donation. These might include, for instance, “cryptokitties,” which are unique collectible online images on which consumers have spent more than $50 million.

b. If property is valued at $500 or more, a charity must sign a donor’s Form 8283 for the gift to be deductible. For gifts over $5,000 that are not publicly traded securities, fair market value must be substantiated. Tax counsel should be consulted about whether the cryptocurrency constitutes a publicly traded security and, if the answer is no, how to substantiate fair market value.

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. Some considerations for a not-for-profit include: How can you learn about and evaluate the donor’s conditions? Is there a written contract with the donor? 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 into 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. viii

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, (212) 219-1800 x283, or visit www.lawyersalliance.org for further information.

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i See N.Y. Prudent Management of Institutional Funds Act, N-PCL Art. 5-A.
ii Id § 552(f).
iii 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 Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (2013), https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering. Likewise, the NY Department of Financial Services requires anyone engaging in “Virtual Currency Business Activity” to obtain a license in most instances. See BitLicense Regulatory Framework (2015), https://www.dfs.ny.gov/legal/regulations/bitlicense_reg_framework.htm.