

ETHICS WATCH

Accepting Bitcoin?

By Nathan M. Crystal

An increasing number of lawyers are accepting client fees in the form of bitcoin. See www.law360.com/articles/498830. Law firms in the UK, Italy, Germany, and Spain have declared their acceptance of bitcoin as a method of payment, and the Israel Bar Association has advised that acceptance of bitcoin is ethically permissible. But what is bitcoin, and is acceptance of bitcoin as payment for fees ethically permissible and desirable?

What is bitcoin?

For detailed information see <https://en.bitcoin.it/wiki/FAQ>. Bitcoin (symbol BTC) has been characterized in many ways: digital currency, digital cash, virtual currency, electronic money, cryptocurrency, or a payment system. The key aspect of bitcoin is that it works peer-to-peer (P2P), i.e. when you subscribe to the bitcoin system by opening a “bitcoin wallet” you can make direct payments to another subscriber either domestically or internationally without using the intermediary of a financial institution and without the backing of a central government, as is the case with “fiat money.” This is not to say that bitcoin or other virtual currencies replace fiat currencies, such as the U.S. dollar. More about the conversion process later in this article.

Why should lawyers consider accepting bitcoin?

The major reason for use of bitcoin is reduction in transaction costs and speed. Transactions involving wire transfers or credit card payments have substantial fees. For example, credit card issuers charge merchants “swipe” or “interchange” fees, typically

between 3-3.5%. Credit card payments also may be subject to charge back if the payor later objects to the transaction. U.S. banks charge \$35-\$45 for international wire transfers, such transfers can be revoked, and delays of several days may occur. By contrast, bitcoin transactions have either no fee or very small fees (at least for the immediate future), are irrevocable, and are typically processed within minutes, the average time being 10 minutes. Two other reasons can be given for using bitcoin: reputational and privacy. Technological savviness and use are reputational factors that may be attractive to certain types of clients. Early acceptors of bitcoin may gain a “first adopter” reputational advantage over other lawyers. Privacy is another factor. Payment in bitcoin is like payment in cash. Clients who wish to maintain privacy may find this form of payment more desirable than traditional non-cash forms of payment that can be more readily traced. Of course, as discussed below, just as cash payments pose ethical risks for lawyers, the same is true for bitcoin transactions.

What are the disadvantages of bitcoin?

(1) Uncertainty. While bitcoin is gaining acceptance in the business and legal communities, lawyers may be reluctant to try a new payment system. In addition, at this writing, to my knowledge no U.S. ethics committee has passed on the use of bitcoin, so lawyers lack authority to support its use.

(2) Value fluctuation. One of the principal differences between bitcoin and other forms of payment is the fluctuation in value of

bitcoins. At the end of 2013, the value rose to almost \$1200 per bitcoin; as of the end of July 2014, the value of a bitcoin was just under \$600. Bitcoins trade like a security, with highs and lows each day. Fluctuation in value may change over time, but no one knows for sure.

(3) Linkage to criminal activity. The cash-like quality of bitcoins means that they are attractive to criminals who want to hide their activities and identities. In October 2013 the FBI announced that it had busted the web’s biggest anonymous drug black market, the Silk Road, and seized almost \$4 million worth of bitcoins, the currency used to buy drugs on the Silk Road.

(4) Security. Bitcoin touts that it has a level of security greater than banks. However, the system is still in beta, so its security remains to be tested.

What are the ethical and legal issues facing lawyers in using bitcoin?

(1) Criminal violations. Lawyers may not ethically counsel or assist clients in conduct that they know is criminal or fraudulent. SCRPC 1.2(d); see also SCRPC 8.4(c). Cash payments from clients to lawyers pose issues of reporting and participation in criminal activity, particularly money laundering. Any person engaged in a trade or business who receives more than \$10,000 in cash in single or related transactions must report the payments to the IRS. 26 U.S.C. §6050I(d). IRS Form 8300 requires disclosure of detailed information about the payor and the transaction. Courts have held that such disclosure does not violate the

attorney-client privilege or the Sixth Amendment Right to Counsel. See *United States v. Goldberger & Dubin, P.C.*, 935 F.2d 501 (2d Cir. N.Y. 1991).

However, recently the IRS ruled that virtual currencies like bitcoin should be treated as “property” rather than a currency. See IR-2014-36, issued March 25, 2014. While it appears that IRS reporting of bitcoin payments is not required under this ruling, the situation remains somewhat unclear because the FAQ notice posted by the IRS at the same time does not specifically address reporting of virtual currencies under Form 8300. See IRS Notice 2014-21. Absent a definite ruling by the IRS or the courts, lawyers who accept bitcoin having a value in excess of \$10,000 face uncertainty regarding reporting under Form 8300.

The federal money laundering statute, 18 U.S.C. §1957, makes it a crime if any person “knowingly engages or attempts to engage in a monetary transaction in criminally derived property that is of a value greater than \$10,000 and is derived from specified unlawful activity.” A monetary transaction includes deposit in a bank account. A lawyer who knowingly takes bitcoin derived from specified criminal activity, including illegal sale of drugs, converts the bitcoin to U.S. dollars, and deposits the funds in a bank account, violates the statute. The U.S. Attorney’s Manual provides some comfort for lawyers on this issue because it rejects application of the concept of “willful blindness” to money laundering claims against lawyers involving receipt of legal fees. USAM 9-105.600. However, the manual is not legally binding on the Justice Department, it does not apply to civil cases, and it has no application to state prosecutors. Further, in fee forfeiture cases, some courts have examined whether lawyers engaged in “due diligence” when accepting cash derived from illegal activity. See *United States v. Moffitt, Zwerling & Kemler, P.C.*, 83

F.3d 660 (4th Cir. 1996) (only due diligence done by firm was to state to clients that it could not take “funny money”). My advice: Exercise reasonable due diligence regarding the client and its source of funds for bitcoin. Lawyers should develop a due diligence checklist that they would follow with regard to any bitcoin transaction.

(2) Business transactions with clients. SCRPC Rule 1.8(a) sets forth standards for business transactions between lawyer and client. While the comments provide that the rule does not apply to ordinary fee arrangements, it does apply “when the lawyer accepts an interest in the client’s business or other nonmonetary property as payment of all or part of a fee.” Under the IRS ruling bitcoin would probably be viewed as nonmonetary fee payment, in which case the requirements of Rule 1.8(a) apply.

(3) Reasonableness of legal fees and expenses. Legal fees and expenses must be reasonable. SCRPC 1.5(a). Because bitcoins can fluctuate in value, if the firm’s engagement calls for payment in bitcoins, the client may object if bitcoins have risen in value from the time of the engagement; on the other hand, if bitcoins have declined in value, the firm may receive less compensation for its services than it anticipated. To avoid this problem, the engagement should provide that the firm’s fees are quoted in dollars but may be paid in the bitcoin equivalent of the quoted dollar fee, provided that the bitcoin/dollar conversion rate will be computed at the time the lawyer converts the bitcoins to dollars so long as the lawyer makes the conversion within a specified reasonable period of time after receipt, for example, two hours after receipt of the bitcoin.

(4) Trust account issues. Clients may make bitcoin payments either for fees already earned and/or retainers. Payment in bitcoin for services already rendered do not go in trust. Such pay-

ments can be immediately converted to U.S. dollars and deposited in the firm’s operating account.

However, retainer payments (and expense deposits) raise trust issues. Trust accounts are governed by SCRPC 1.15 and SCACR 412 and 417, but these rules do not deal specifically with virtual currencies. While the South Carolina Supreme Court might treat bitcoin as property, as the IRS has done, it is not required to do so. The Court could also deal with virtual currencies by amendments to these rules.

If bitcoin is treated as property, then a lawyer must keep the property “separate from the lawyer’s own property” and it must be “identified” and “appropriately safeguarded.” See SCRPC 1.15(a). The firm’s bitcoin wallet coupled with proper safeguarding of the wallet key should be sufficient safekeeping, but compliance with the “separate” requirement is unclear. On the other hand, if bitcoin is treated as the equivalent of

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cash, then trust account issues arise. In that case, the lawyer must deposit the funds in a separate trust account. The problem is that bitcoins cannot be deposited in an account. Indeed, one of the reasons for the creation of bitcoin was avoidance of the need for intermediary financial institutions. Regardless of whether bitcoins are treated as property or cash, perhaps the firm could establish a “bitcoin trust wallet” that it would use like a trust account, but the value of the bitcoins in the trust wallet could fluctuate. Under this line of analysis, it seems that a lawyer could not accept bitcoins as retainer fees, only in payment for services rendered. This reasoning would make bitcoin transactions undesirable for many lawyers. An alternative is “immediate conversion.” Under agreement with the client, when the lawyer receives a bitcoin retainer, the lawyer would immediately convert the bitcoins to U.S. dollars and deposit the dollars in

the firm’s trust account. The trust account would be handled in the normal fashion, although there might be one problem. If the lawyer later receives funds on behalf of the client—for example, settlement of a litigation matter or payment in a transactional matter or if the lawyer owes the client a refund at the conclusion of the matter—and the engagement agreement provides for payment to the client in bitcoins, the lawyer would have to transfer the trust funds to the firm’s account with a bitcoin conversion provider, and then send the bitcoins through the firm’s bitcoin account to the client. This conversion would involve trust funds going into the firm’s general accounts, which is improper under traditional rules.

I can offer three possible ways of dealing with this problem:

- client consent, but query whether that is sufficient to deal with what would otherwise be a trust account violation;

- client agreement that any disbursements or refunds would be made in U.S. dollars by check or wire rather than bitcoin, although this might not be acceptable to the client;
- client agreement that any disbursements or refunds would be made from the firm’s operating account with the firm to be reimbursed from funds held in trust, although this might be viewed as the equivalent of the first solution, and therefore a trust account violation, and could pose liquidity problems for the firm if the payment to the client was substantial.

Bitcoin is an innovative, exciting development. However, acceptance of bitcoin raises some tricky legal and ethical issues that law firms need to consider carefully before accepting this new form of payment. I plan to explore these and other bitcoin ethical issues in more detail on my blog at www.techethics.com. I welcome your comments. ☺

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