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Bitcoin Accepted Here?

What Bitcoin is and should you use it



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Larry Braun and Zachary Turke are corporate lawyers with the Los Angeles office of Sheppard Mullin who advise clients ranging from family-owned businesses to multinational corporations in many diverse industries, including technology, healthcare, consumer goods, aerospace and defense, financial services, and manufacturing. Their principal areas of practice are merger and acquisition transactions, joint ventures, general corporate law, corporate finance and securities law, contractual matters (including licensing and distribution arrangements), healthcare transactions, and general business counseling. Sheppard Mullin is a full-service law firm with 15 offices throughout the world, including seven local offices in California.

We are all reading about Bitcoin, but very few people really know what it is or how to use bitcoins. With price volatility that can make the stock market look tame by comparison and a number of recent arrests in the trading community, most people have shied away from Bitcoin. So what exactly is a bitcoin and should you use them?

At its heart, Bitcoin is an electronic peer-to-peer payment system that facilitates the purchase of real-world goods and services using the Internet. Unlike traditional online payment systems like PayPal, however, Bitcoin does not conduct these transactions using the dollar or other government currencies. Instead, Bitcoin transactions are conducted in a currency called a bitcoin, a virtual digital currency that is unrelated to any government.

Bitcoins enter circulation as compensation to individuals who assist with verifying the accuracy of bitcoin transactions, a process called bitcoin mining. Mining requires specialized hardware, however, putting it beyond the purview of most individuals. Instead, average people generally obtain bitcoins by purchasing them using their local currency at an online Bitcoin exchange from a seller who already has them. As there are only a finite number of bitcoins in circulation at any time, bitcoins have a floating exchange rate that is set by market forces. This means that the value

of a bitcoin changes all the time.

Once purchased, bitcoins are stored in an online storage program called a wallet, which looks a lot like your online bank account, each of which has a unique electronic address. Sellers offering goods or services and who accept bitcoins have a similar wallet. Payments are made by entering the seller's wallet address, selecting the number of bitcoins to be transferred, and pressing send. According to Bitcoin, transferring funds from Canada to Africa takes approximately 10 minutes.

And while all of that may sound exceedingly complex, Bitcoin is nevertheless beginning to enter mainstream commerce. In January 2014, online retailer Overstock.com began accepting bitcoins, doing \$126,000 of business in the digital currency on the first day. Virgin Galactic also already accepts the currency and Zynga soon will. And in California, you can even use it to purchase a Tesla automobile or see a Sacramento Kings game.

So what are the advantages that are causing businesses and consumers to flock to Bitcoin? Since bitcoin transactions are accomplished person-to-person via the Internet, banks and clearing houses are completely eliminated, making the fees associated with Bitcoin transactions either non-existent or much lower than credit card transactions. For individuals, Bitcoin also offers

the benefits of eliminating bank freezes, spending limits, and credit checks. For business owners, chargeback fraud is eliminated (a Bitcoin transaction is irreversible) and Bitcoin boasts a built-in community of potential customers.

But as with any new technology, Bitcoin is not without its drawbacks. Extreme volatility is the primary risk, meaning that you may be left holding a currency that is worth far less than when you accepted it due to the fact that Bitcoin exchange rates change, sometimes wildly, on a daily basis.

Government intervention also cannot be ignored. China, for example, has prohibited the exchange of bitcoins for Yuan, and Russia appears to be taking similar steps. To date, the U.S. government has taken a hands-off approach; however, the Treasury Department has

said it may regulate certain businesses accepting bitcoins as money transmitters in the future.

Finally, it is not clear whether bitcoins will be taxed as capital assets subject to capital gains rates or as fiat currencies taxed at the ordinary income rate. The IRS has been silent on this issue, but indicates it continues to study developments.

Given the significant risks associated with this nascent technology, Bitcoin is likely still not a great fit for most people or businesses. If bitcoin valuations stabilize and the technology and related infrastructure matures, however, it is likely that you may have some bitcoins in your "wallet" in the foreseeable future. As always, however, you should consult with your lawyer and tax advisor before branching out into the brave new world of the bitcoin.

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