




WORLD WIDE WEB OF UNDERGROUND VIRTUAL CURRENCIES: IMPLICATIONS FOR GAMING

By Peter J. Kulick and Michael D. Lipton



An effect of the challenging economic conditions of the past five years is fluctuation in the value of worldwide currencies. For those of us living near the U.S.-Canada border, there is still some level of mild shock that the Canadian and U.S. dollars have nearly the same value, with the Canadian dollar even exceeding the value of the U.S. dollar. More recently, the euro has experienced a sharp decline in value vis-à-vis the U.S. dollar.

With the Internet growing exponentially as a medium of commerce, it was simply a matter of time before the introduction of virtual currencies. The use of virtual currencies has exploded in recent years. Retailers, like Amazon, have introduced captive virtual currencies that can be used to directly purchase goods from their websites. Similarly, widely used virtual currencies have also developed. Notably, "Bitcoin," which was developed by the elusive Satoshi Nakamoto¹, has been at the forefront of virtual currencies.

What are Virtual Currencies? Why all the Hoopla?

Virtual currencies are ultimately unregulated and decentralized currencies. Virtual currencies do not carry the status as a legal tender in any jurisdiction.

Bitcoin, which has generated the most media attention, is illustrative. Bitcoin operates as a peer-to-peer virtual currency. Bitcoin has a finite number of 21 million units that will be issued. Approximately 11 million Bitcoins have already been issued. Bitcoins are distributed through a "mining" process, whereby "miners" supply the Bitcoin network through complex computer processing. Miners are awarded blocks of issued Bitcoin, each of

which currently contains 25 Bitcoins. Each Bitcoin carries the entire history of the transactions it has undergone within its code.

The excitement surrounding Bitcoins and other virtual currencies in some respects can be traced to a libertarian ideology. Specifically, Bitcoin is decentralized and operates without the trust of a banking system or a government. The perceived benefit is that the decentralized nature of the virtual currency can avoid government manipulation of the value of the currency. Moreover, virtual currencies do not need to rely upon a banking system to preserve the safety of the currency.

More recently, Bitcoin, like other virtual currencies, has received the attention of the general public as a result of rapidly increasing values. As recently as early May, the value of one Bitcoin was approximately US\$112. Recent news reports have also detailed stories of businesses accepting Bitcoins, or other virtual currencies, as a payment medium. Individuals have joined the fray by demanding payment for goods or services in Bitcoins due to perceived fears of the imminent collapse of currencies that operate as the legal tender in a particular jurisdiction.

The Role of Virtual Currencies in Gaming

In the gaming context, virtual currencies have arisen in at least two distinct categories. First, many social games have introduced virtual currency features, such as Zynga poker chips or World of Warcraft gold. Players earn the virtual currency by carrying out tasks during the course of the gaming play.

Second, virtual currencies have begun to be used as the consideration and/or reward for wagers placed through i-gaming sites. Examples of the latter categories include SatoshiDICE and Bitbook.biz.

The use of virtual currencies presents several legal implications, ranging from the permissibility of such activities to financial regulations to tax issues.

Legal Implications of Virtual Currencies Under U.S. Gaming Laws

Gambling is historically defined at common law as consisting of three elements: chance, consideration and prize. Typically, sponsors of i-gaming sites argue that a particular game does not constitute gambling because one of the three common law elements is lacking. That is, all of the elements for an activity to be deemed to be "gambling" are not present. For instance, operators of real money Internet poker sites often argued that the websites were not engaged in prohibited gambling activity because poker is a game of skill. Thus, the operators of Internet poker sites contended that the poker games lacked the element of chance.

In the context of virtual currencies, sponsors of i-gaming sites could assert that the virtual currencies do not arise to gambling because the use of a virtual currency either lacks consideration or a prize. However, the fallacy of such an assertion is that the argument would necessarily have to be premised on the basis that virtual currencies have no value. Bitcoin is illustrative that

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virtual currencies indeed carry value. For instance, news reports have detailed that individuals would only accept Bitcoins in exchange for the sale of valuable assets, such as real estate. Furthermore, markets have developed whereby holders of virtual currencies can exchange the virtual currencies for legal tender (i.e., U.S. dollars or euros). Thus, virtual currencies likely have value.²

The operation of gambling games using virtual currencies could very well run afoul of a multitude of U.S. federal laws.³ The Unlawful Internet Gaming Enforcement Act (UIGEA) is one of the primary federal laws that U.S. prosecutors have relied upon to prosecute i-gaming operators. UIGEA ostensibly prohibits i-gaming in the United States.

UIGEA establishes a criminal offense, inter alia, if (a) a person engaged in the “business of betting or wagering” (b) knowingly accepts, in connection with the participation of another person, (c) in unlawful internet gambling (d) credit or the proceeds of credit. UIGEA defines “bet or wager” to include the traditional common law elements of gambling: (a) risking something of value, (b) upon the outcome of “a game subject to chance” and (c) a reward based on the occurrence of a certain outcome. Unlawful Internet gambling” is defined by UIGEA to include placing, receiving or otherwise knowingly transmitting a bet or wager that uses the Internet where the bet or wager is unlawful under any applicable U.S. federal or state law where the bet is initiated, received or otherwise made. Hence, simply using a virtual currency in place of U.S. dollars, or another legal tender, likely would not pull an activity outside the scope of UIGEA.

U.S. Tax Law Implications of Virtual Currencies

U.S. tax law broadly defines “gross income” to include all accessions to wealth. U.S. tax law have long recognized that barter exchanges can result in the realization and recognition of income. Accordingly, the exchange of goods or services in return for units of a virtual currency may produce gross income subject to U.S. income taxation. From a gaming context, winning units of a virtual currency would therefore likely result in a taxable event.

Financial Regulation of Virtual Currencies

On March 18, the U.S. Financial Crimes Enforcement Network (FinCEN) released interpretative guidance with respect to the creation, distribution, exchange and transmission of virtual currencies under the U.S. Bank Secrecy Act (BSA). Subject to certain limitations and exceptions, the BSA requires money services businesses to satisfy the FinCEN registration, reporting and recordkeeping regulations. The FinCEN guidance addresses whether a user, exchanger or administrator constitutes money services businesses for purposes of the BSA.

The FinCEN guidance defines a user as “a person that obtains virtual currency to purchase goods or services.” The FinCEN guidance concludes that a user is not a money service business and thus not subject to the registration, reporting and recordkeeping requirements of the BSA.

An exchanger is defined under the FinCEN guidance as “a person engaged as a business in exchange of virtual currency for real currency, funds or other virtual currency.” The FinCEN guidance defines an administrator as “a person engaged as a business in issuing (putting into circulation) a virtual currency

and who has the authority to redeem (to withdraw from circulation) such virtual currency.” The guidance continues by providing that an exchanger or administrator may be a money transmitter, subject to regulation, if the person either accepts and transmits a convertible virtual currency or buys or sells convertible currency for any reason.

The import of the FinCEN guidance is that a person obtaining a virtual currency to acquire goods or services would likely constitute a user. As an example, a person that acquires Bitcoins to purchase goods from a website would appear to qualify as a user under the FinCEN guidance. Accordingly, the person would not be subject to registration and regulation under the BSA.

On the other hand, a payment processor or virtual currency miner would appear to qualify as an exchanger and an administrator, respectively. Thus, these persons would be subject to registration and regulation under the BSA.

Conclusion

The presence of virtual currencies has exploded in recent years. Virtual currencies have begun to become accepted alternative currencies. These currencies have become increasingly popular both in social games and with i-gaming sites. The use of virtual currencies raises a threshold question with regard to whether such use in itself can pull an activity outside of the scope of the legal definition of gambling. Virtual currencies likely carry value, as evidenced by the ability to convert the virtual currencies into legal tender (such as U.S. dollars) or trade the virtual currencies for other valuable property (such as real estate). Additionally, in the U.S., the use of virtual currencies can have tax consequences, as well as present financial regulation considerations.

1 Satoshi Nakamoto has been described as an attractive, young Japanese lady who died several years ago. Satoshi Nakamoto is likely an anonymous or pseudonymous developer or group of developers of Bitcoin.

2 Similarly, the case of U.K. hacker Ashley Miller also demonstrates that virtual currencies can carry value.

3 In addition to UIGEA, other U.S. laws that have been used to prosecute i-gaming activities include the Wire Act, Unlawful Gambling Paraphernalia Act, 18 USC § 1953, the Travel Act, 18 USC § 1952, and the Illegal Gambling Business Act, 18 USC § 1955.

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