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Robert W. Stocker II, Gaming Law
517.487.4715 • rstocker@dickinsonwright.com

Dennis J. Whittlesey, Gaming Law/Indian Law
202.659.6928 • dwhittlesey@dickinsonwright.com

Michael D. Lipton, Q.C., Gaming Law
416.866.2929 • mdliptonqc@dickinsonwright.com

Peter H. Ellsworth, Gaming Law/Indian Law
517.487.4710 • pellsworth@dickinsonwright.com

Glenn M. Feldman, Gaming Law/Indian Law
602.285.5138 • gfeldman@dickinsonwright.com

Peter J. Kulick, Gaming Law/Taxation
517.487.4729 • pkulick@dickinsonwright.com

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416.367.0899 • kweber@dickinsonwright.com

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DIGITAL CURRENCY IDENTIFIED AS AN "EMERGING RISK" IN THE CANADIAN FEDERAL GOVERNMENT'S 2014 BUDGET

by Michael D. Lipton, Q.C., Kevin J. Weber, and Jack I. Tadman

On February 11, 2014, the Canadian Federal Government released its 2014 Budget. In the 2014 Budget, the Federal Government pledged to introduce legislative amendments to strengthen Canada's anti-money laundering and terrorist financing regime in the area of virtual (digital) currency.

2013: Year of Bitcoin?

At the beginning of 2013, one bitcoin could be purchased for \$12. For a brief period in November 2013, one bitcoin was worth more than one ounce of gold (\$1242 to \$1240, respectively). Forbes and MarketWatch wrote articles proclaiming 2013 as the year of bitcoin,¹ and "bitcoin" was chosen as the word of the year by the Australian National Dictionary Centre (beating out worthy candidates, including "selfie" and "twerk").

This increased popularity of digital currency has brought increased scrutiny from regulators and law enforcement. Last year in the United States, the Financial Crimes Enforcement Network issued guidance with respect to whether activities by individuals and companies related to virtual currencies are subject to registration, reporting, and recordkeeping requirements, and the FBI arrested the "mastermind" of Silk Road (a marketplace selling illegal items and accepting payment in virtual currency). In early 2014, a prominent member of the bitcoin community was indicted on money laundering charges.

Canada Revenue Agency ("CRA") Releases Its Position on Bitcoin

Prior to the release of the 2014 Budget, the main Canadian government references to digital currency were from the CRA. The first notable CRA acknowledgment of bitcoin was in April 2013 in the form of a CRA communication to the Canadian Broadcasting Corporation ("CBC"). The communication stated that transactions involving bitcoin are barter transactions and that gains resulting from bitcoin transactions could be income or capital depending on the specific facts.

On November 5, 2013, the CRA issued its first release on the taxation of digital currency. This release reinforced the CRA's earlier position on bitcoin that was set out in its April 2013 e-mail to the CBC. On December 23, 2013, in CRA Document No. 2013-051470117, subject "Bitcoins," the CRA further clarified its position with respect to bitcoin "in response to a summary of comments that were provided in response to a recent media enquiry describing the income tax consequences of various transactions involving digital currency."

Accordingly, the CRA considers bitcoin to be a commodity, not a currency. Therefore, using bitcoins to purchase goods or services is considered a barter transaction. The sale of bitcoins at a profit is treated as either income or capital depending on a particular taxpayer's circumstances.

Virtual Currency in the 2014 Budget

Virtual currency is identified in the 2014 Budget as an "emerging risk" that threatens Canada's international leadership in the fight against money laundering and terrorist financing. Bitcoin is cited in the 2014 Budget as an example of such virtual currency.

In the 2014 Budget, the Federal Government proposed to introduce anti-money laundering and anti-terrorist financing regulations for virtual currencies, such as bitcoin.

The Federal Government noted in the 2014 Budget that this proposal was based on a report by the Standing Senate Committee on Banking, Trade and Commerce entitled *Follow the Money: Is Canada Making Progress in Combatting Money Laundering and Terrorist Financing? Not Really* (the "Report"). The Report is a five-year review of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (the "Act") and was issued in March 2013. However, the only reference in the Report to digital currency is a brief note that the development of electronic methods to launder money must be addressed through timely amendments to the Act and its regulations.

2014: Year of Bitcoin Regulation

The Federal Government has identified digital currency as an "emerging risk" in the fight against money laundering and terrorist financing. Accordingly, the regulation of digital currency in Canada is imminent, and individuals and businesses dealing in bitcoin will soon be subject to certain registration, reporting, and recordkeeping requirements.

¹ See "2013: The year of bitcoin" at <http://blogs.marketwatch.com/thetell/2013/12/31/2013-the-year-of-bitcoin/> (MarketWatch) and "2013: Year Of The Bitcoin" at <http://www.forbes.com/sites/kitconews/2013/12/10/2013-year-of-the-bitcoin/> (Forbes).

Michael Lipton, Kevin Weber, and Jack Tadman are lawyers in our Toronto office. Michael Lipton can be reached at 416.866.2929 or mdliponqc@dickinsonwright.com, Kevin Weber can be reached at 416.367.0899 or kweber@dickinsonwright.com, and Jack Tadman can be reached at 416.777.4018 or jtadman@dickinsonwright.com.