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Submitted electronically to [public\\_comment@ethics.state.tx.us](mailto:public_comment@ethics.state.tx.us)

Mary K. Kennedy, Chair  
c/o Anne Temple Peters  
Texas Ethics Commission  
P.O. Box 12070  
Austin, Texas 78711-2070

**Re: Comments on Proposed Regulation of Virtual Currency**

Dear Chair Kennedy,

The Campaign Legal Center (“CLC”) respectfully submits these written comments to the Texas Ethics Commission (“the Commission”) in response to the Proposed Rule 1 Tex. Admin. Code § 22.37 (“Proposed Regulation”).<sup>1</sup>

CLC is a nonpartisan, nonprofit organization dedicated to protecting and strengthening democracy through law at all levels of government. Since its founding in 2002, CLC has participated in every major campaign finance case before the U.S. Supreme Court and in numerous other federal and state court proceedings. Our work promotes every American’s right to an accountable and transparent democratic system.

CLC commends the Texas Ethics Commission’s decision to promulgate regulations regarding political committees’ acceptance and use of virtual currency in light of its growing usage in the marketplace. We make the following comments and recommendations in an effort to assist the Commission’s rulemaking on this important issue.

**I. Background**

Over the last decade, virtual currency<sup>2</sup> (the most well-known subset of which is cryptocurrency) has emerged as an increasingly popular and valuable alternative to traditional government-issued (or “fiat”) currency.<sup>3</sup> The

<sup>1</sup> 47 Tex. Reg. 6707 (Oct. 14, 2022) (to be codified at 1 Tex. Admin. Code § 22.37), *available at* <https://www.sos.state.tx.us/texreg/pdf/backview/1014/1014is.pdf>.

<sup>2</sup> The Texas Business and Commercial Code defines “virtual currency” as “a digital representation of value that . . . is used as a medium of exchange, unit of account, or store of value” and “is not legal tender, whether or not denominated in legal tender.” Under the statute, “virtual currency” specifically excludes affinity and rewards programs in which value cannot be exchanged for legal tender, bank credit, or virtual currency, and “digital representation(s) of value” issued by and used solely in the context of an online game, game platform, or family of games. Tex. Bus. & Com. Code § 12.001.

<sup>3</sup> See Georgina Tzanetos, *Cryptocurrency statistics 2022: Investing in crypto*, Bankrate (July 8, 2022), <https://www.bankrate.com/investing/cryptocurrency-statistics/> (documenting the rise in cryptocurrency popularity and market trends from the invention of bitcoin in 2009 to July 2022); see also, U.S. INTERNAL REVENUE SERVICE, *Frequently Asked Questions on Virtual Currency Transactions* (last updated Mar. 23, 2022) <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions> (hereinafter “IRS FAQ”) (answering frequently asked questions regarding virtual currency, cryptocurrency, and their relationships to the U.S. dollar for federal tax purposes); and TEX. STATE SECURITIES BOARD, *Fiat v. Virtual Currency* (accessed Nov. 7,

number of individuals who own bitcoin and other cryptocurrency is difficult to precisely track, but 16% of Americans reported investing in, trading, or using a cryptocurrency, as of July 2022.<sup>4</sup> Thousands of different cryptocurrencies are available for exchange around the globe, and nearly 600 cryptocurrency exchanges serve investors worldwide.<sup>5</sup> As public attention to virtual currency has skyrocketed, political campaigns also have begun to explore its possibilities. The Federal Election Commission (“FEC”) has addressed bitcoin contributions in an advisory opinion,<sup>6</sup> while states like California, Colorado, Iowa, and Tennessee have issued guidance or moved to regulate cryptocurrency in state and local political donations.<sup>7</sup>

There are two major types of virtual currencies – centralized and decentralized.<sup>8</sup> Centralized virtual currencies have a central administrator or repository, usually the issuer of that currency, similar to a central bank.<sup>9</sup> Decentralized virtual currencies, by contrast, have no central repository or administrator, and typically exist as a peer-to-peer network, although transmission or exchange of such currencies can be facilitated by independent service providers, such as exchanges or payment processors.<sup>10</sup>

The most well-known type of virtual currency is cryptocurrency, a decentralized mode of virtual currency that has been the primary focus of regulators, donors, and political committees in the campaign finance sphere, and these recommendations will focus on its use.<sup>11</sup>

Like cash, cryptocurrency is essentially a medium of exchange used to purchase goods and services.<sup>12</sup> Third-party exchanges allow holders of cryptocurrency, such as bitcoin, to transfer or convert it to traditional currency, and vice-versa.<sup>13</sup> However, cryptocurrency systems share two key features that distinguish them from other monetary forms: independence

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2022), <https://www.ssb.texas.gov/fiat-v-virtual-currency> (explaining the difference between virtual and traditional/fiat currencies in plain language for individual investors in Texas).

<sup>4</sup> Michelle Faviero and Navid Massarat, *46% of Americans who have invested in cryptocurrency say it's done worse than expected*, Pew Research Center, Aug. 23, 2022, <https://www.pewresearch.org/fact-tank/2022/08/23/46-of-americans-who-have-invested-in-cryptocurrency-say-its-done-worse-than-expected/>.

<sup>5</sup> In November 2022, over 18,000 cryptocurrencies were available to for exchange. *Historical Snapshot – 06 November 2022*, CoinMarketCap (Accessed Nov. 7, 2022), <https://coinmarketcap.com/historical/20221106/>; see also Javier Paz, *The Best Global Crypto Exchanges*, Forbes, March 16, 2022, <https://www.forbes.com/sites/javierpaz/2022/03/16/the-best-global-crypto-exchanges/?sh=eb67ae1742c0>.

<sup>6</sup> The FEC issued an advisory opinion authorizing a political committee’s receipt of bitcoin contributions, subject to certain valuation and reporting procedures, in 2014. Fed. Election Comm’n Advisory Op. 2014-02 at 3-9 (May 8, 2014), <https://www.fec.gov/files/legal/aos/2014-02/2014-02.pdf> (hereinafter “FEC AO”). The FEC also determined the political committee could use its campaign funds to purchase bitcoin for investment purposes, provided that the committee liquidated the bitcoin and deposited the proceeds into its campaign account prior to making any expenditures with the proceeds. *Id.* at 7. The Commission did not reach a consensus on whether the committee could make expenditures for goods and services using bitcoin, or whether bitcoin contributions are equivalent to cash contributions under federal law. *Id.* at 9.

<sup>7</sup> See Todd Ehret, *Crypto contributions to US election campaigns require legal navigation*, Thompson Reuters, Sept. 13, 2022, <https://www.thomsonreuters.com/en-us/posts/news-and-media/crypto-election-contributions/>; Tess Bonn, *Politicians are getting in on the cryptocurrency craze to fund campaigns*, CNBC, March 2, 2018, <https://www.cnbc.com/2018/03/01/cryptocurrency-candidates-politicians-embrace-bitcoin.html>.

<sup>8</sup> REPORT OF THE ATTORNEY GENERAL’S CYBER DIGITAL TASK FORCE: CRYPTOCURRENCY ENFORCEMENT FRAMEWORK, U.S. DEPT. OF JUSTICE, 2-3 (Oct. 2020), <https://www.justice.gov/archives/ag/page/file/1326061/download> (hereinafter “AG’s Report”); see also Charles G. Cooper, Supervisory Memorandum – 1037, 2-3, Tex. Dept. of Banking (April 1, 2019), available at <https://www.dob.texas.gov/sites/default/files/files/consumer-information/sm1037.pdf> (hereinafter “Cooper Memo 1037”).

<sup>9</sup> See Cooper Memo 1037 at 2.

<sup>10</sup> *Id.* at 2-3.

<sup>11</sup> *Supra* note 7.

<sup>12</sup> *Id.* at 1-2, 4-5; see also, SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM 1 (2009), <https://bitcoin.org/bitcoin.pdf> (describing Bitcoin as an “electronic payment system based on cryptographic proof”).

<sup>13</sup> See U.S. GOV’T ACCOUNTABILITY OFFICE, VIRTUAL ECONOMIES & CURRENCIES 5 (May 2013), <https://www.gao.gov/assets/660/654620.pdf> (hereinafter “GAO report”).

from any central authority issuing them or facilitating transactions; and the ability of users to transact pseudo-anonymously through cryptographic units, also known as the blockchain.<sup>14</sup>

By design, cryptocurrency systems operate outside channels of central authority. In lieu of standard banking processes, the verification of cryptocurrency transfers occurs through the blockchain—a collective ledger of transactions maintained by a decentralized network of operators.<sup>15</sup> As opposed to checks or credit cards, cryptocurrency transactions are not processed through a financial institution, which substantially impedes efforts to verify or trace the transactions with standard audit tools, such as account records.<sup>16</sup>

Cryptocurrency transactions can take place without either party disclosing any personally identifying information. For example, although every bitcoin transaction is publicly recorded in the blockchain, along with the transacting parties' respective "bitcoin addresses," no information about the "real life" identity of either party is documented in the exchange.<sup>17</sup> In addition, users may generate a limitless number of bitcoin addresses, and a bitcoin user may use a new address for every transaction made in his or her lifetime.<sup>18</sup>

Decentralization and functional anonymity are deliberate features of cryptocurrency's design, intended to insulate bitcoin and derivative platforms from central control.<sup>19</sup> These design qualities make regulation of cryptocurrency challenging under existing legal frameworks, including campaign finance law. However, there are existing processes that can help overcome these issues.

Cryptocurrency can be exchanged directly, in peer-to-peer transactions, but it is also commonly exchanged through an intermediary called an "exchange" or through a payment processor.<sup>20</sup> Peer-to-peer transactions present the most difficulty in tracing transactions.<sup>21</sup> Exchanges and payment processors, though, provide avenues for government agencies to ensure legal obligations, including campaign finance requirements, are not circumvented through the use of cryptocurrency. Cryptocurrency exchanges and payment processors ("service providers") face growing regulation, compared to more anonymous peer-to-peer interactions. The U.S. Treasury Department requires U.S.-based service providers to utilize "know-your-customer" ("KYC") protocols, which

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<sup>14</sup> Jan Lansky, *Possible Approaches to Cryptocurrency*, 9 J. SYSTEMS INTEGRATION 19, 20 (Jan. 2018), <http://si-journal.org/index.php/JSI/article/viewFile/335/325>. "The term pseudo-anonymity is used for anonymity in cryptocurrencies. Transacting parties are not identified by their actual proper names or otherwise used identifiers but those parties still have identifiers (cryptocurrency account addresses)." *Id.* at 22; see also AG's Report, *supra* note 8, at 3-4.

<sup>15</sup> Marco Iansiti & Karim R. Lakhani, *The Truth About Blockchain*, HARV. BUS. REV., Jan.-Feb. 2017, <https://hbr.org/2017/01/the-truth-about-blockchain>.

<sup>16</sup> "It may seem elegant [] to simply treat a Bitcoin address as a bank account. However, KYC-compliant bank accounts differ from Bitcoin addresses in that they require full legal names be attached to [an] account. Because it is impossible to find the true owner of a Bitcoin address, or even a list of persons with access to the account, there is no particular way to determine the owner of any of the funds or the person that authorized the donation. Even a full police investigation would be unlikely to trace the origin of any particular funds. This means that a single pool of funds can be used, untraceably, to make unlimited donations to any particular committee." Comment of Louis Joyce on Fed. Election Comm'n Draft Advisory Op. 2014-02 (Apr. 17, 2014), <https://www.fec.gov/files/legal/aos/2014-02/1255510.pdf>.

<sup>17</sup> See GAO report, *supra* note 13, at 7, fig. 2. A bitcoin address consists of a string of alphanumeric characters, randomly generated at no cost for a bitcoin user. Lansky, *supra* note 14, at 21.

<sup>18</sup> Lansky, *supra* note 14, at 21.

<sup>19</sup> See generally, Nakamoto, *supra* note 12; Alan Feuer, *The Bitcoin Ideology*, N.Y. TIMES, Dec. 14, 2013, <https://www.nytimes.com/2013/12/15/sunday-review/the-bitcoin-ideology.html>.

<sup>20</sup> Kendall Little, *Want to Buy Crypto? Here's What to Look for In a Crypto Exchange*, TIME (May 3, 2022), <https://time.com/nextadvisor/investing/cryptocurrency/what-are-cryptocurrency-exchanges/>.

<sup>21</sup> AG's Report, *supra* note 8, at 15.

link a verified real-world identity to blockchain addresses and cryptocurrency transactions.<sup>22</sup>

KYC protocols typically require customers to provide their date of birth, Social Security number, and physical address.<sup>23</sup> Some exchanges and payment processors require customers to provide a valid government-issued ID, for example a driver's license or passport, which is used by the service provider to verify the user's identity.<sup>24</sup> This procedure is meant to prevent illegal activities, including money laundering and tax evasion.<sup>25</sup>

While KYC protocols are not a panacea for crime prevention,<sup>26</sup> they provide useful information for regulators and law enforcement.<sup>27</sup> Beginning in 2020, all federal tax filers have been required to answer a "yes or no" question regarding whether they have participated in cryptocurrency transactions, and beginning in 2023, cryptocurrency exchanges will be required to send U.S. Taxpayers 1099-B forms, commonly required by investment brokerages.<sup>28</sup> This increased regulation, in combination with the use of KYC protocols in many exchanges, provides a strong avenue for state agencies seeking to enforce transparency laws and regulations while allowing cryptocurrency donations to political committees.

## II. Recommendations for Proposed Regulation

The decentralized structure and pseudo-anonymity of cryptocurrency transactions pose challenges to Texas' current disclosure requirements, as well as its source restrictions on campaign contributions and, in judicial races, contribution amount limitations.<sup>29</sup>

As an initial matter, a contribution of cryptocurrency clearly falls within the scope of Texas' campaign finance law. Under the Texas Election Code, a "contribution" generally is defined as a "direct or indirect transfer of money, goods, services, or *any other thing of value* and includes an agreement made or other obligation incurred, whether legally enforceable or not, to make a transfer."<sup>30</sup> As something of "value," a contribution of virtual currency provided to a candidate or committee in Texas would satisfy the Election Code's definition of "contribution."

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<sup>22</sup> Lyle Daly, *What is KYC and Why Do Crypto Exchanges Require It?*, The Ascent: A Motley Fool Service (Sept. 29, 2021), <https://www.fool.com/the-ascent/cryptocurrency/articles/what-is-kyc-and-why-do-crypto-exchanges-require-it/>.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> See, e.g., Greg Iacurci, *Cryptocurrency poses a significant risk of tax evasion*, CNBC, May 31, 2021, <https://www.cnbc.com/2021/05/31/cryptocurrency-poses-a-significant-risk-of-tax-evasion.html>; see also, *Beginner's Guide to Bitcoin Mixing*, Bitcoin Blender (accessed Nov. 7, 2022), available at <https://bitblender.io/guide.html> (providing information regarding "bitcoin mixing," tactic involving a wallet address that combines coins with other transactions, used by those who want to evade scrutiny and make it harder to trace any single transaction).

<sup>27</sup> See Nicole Perlroth, Erin Griffith and Katie Benner, *Pipeline Investigation Upends Idea That Bitcoin is Untraceable*, N.Y. TIMES (June 9, 2021), <https://www.nytimes.com/2021/06/09/technology/bitcoin-untraceable-pipeline-ransomware.html>, and Dalvin Brown, *Tracking stolen crypto is a booming business: How blockchain sleuths recover digital loot*, WASH. POST, Sept. 22, 2021, <https://www.washingtonpost.com/technology/2021/09/22/stolen-crypto/>; see also, Joseph Cox, *IRS Now Has a Tool to Unmask Bitcoin Tax Cheats*, Daily Beast (August 22, 2017), <https://www.thedailybeast.com/irs-now-has-a-tool-to-unmask-bitcoin-tax-cheats>.

<sup>28</sup> See MoneyWatch, *Yes, taxpayers must report their cryptocurrency trading to the IRS. Here's how*, CBS News (Jan. 26, 2022) <https://www.cbsnews.com/news/cryptocurrency-trading-taxes-irs/>.

<sup>29</sup> See, e.g., Tex. Elect. Code §§ 253.001 (prohibiting contributions in the name of another), 253.006 and 253.007 (prohibiting contributions from lobbyists and lobbying by political contributors), 253.101 (prohibiting contributions to candidates by corporations or with funds derived from membership dues or fees for labor organizations), 253.155 (providing contribution limits for judicial races); Tex. Ethics Comm. Op. No. 207 (1994) (discussing statutory provisions that together prohibit anonymous contributions).

<sup>30</sup> Tex. Elec. Code § 251.001.

Although its digital underpinning is unique, cryptocurrency presents some similar enforcement challenges to both cash contributions and in-kind contributions of assets like stocks. Like cash, cryptocurrency offers a “facile[]medium for unethical and illegal activities” because many modes of use emphasize “untraceability and easy transferability.”<sup>31</sup> For instance, unlike contributions made by check or credit card, a bitcoin contribution requires only a bitcoin address, “which does not contain any personal identifying information.”<sup>32</sup> Thus, under many modes of transfer, the inability to uncover the actual source of a cryptocurrency contribution with standard audit mechanisms could facilitate a range of unlawful conduct.<sup>33</sup>

Since cryptocurrency systems allow users to create an unlimited number of addresses for transactions, they readily furnish a means for unscrupulous donors to funnel excess contributions through straw donor transactions.<sup>34</sup> Moreover, cryptocurrency could provide a relatively simple method for foreign entities and other prohibited sources to direct money into Texas elections surreptitiously.<sup>35</sup>

The current proposed rule seeks to regulate cryptocurrency donations as “in-kind contributions.” Unlike consumable goods usually provided as in-kind contributions, which the recipient committee uses directly, cryptocurrency is “a digital representation of value that functions as a medium of exchange”;<sup>36</sup> in other words, cryptocurrency’s main use is to purchase goods and services, either directly or by liquidating cryptocurrency for traditional currency to be used for purchases. Cryptocurrency’s function as a medium of exchange also distinguishes it from stocks, bonds, and other securities necessitating liquidation before they can be used to make campaign expenditures.

As cryptocurrency’s popularity has grown in recent years, it has also drawn speculators seeking to make a profit or investment, rather than using it as a medium of exchange. This has prompted government agencies, including the Texas State Securities Board and the federal Securities and Exchange Commission (SEC) to address investment and speculation in cryptocurrency in official guidance and statements.<sup>37</sup>

The SEC has indicated its intent to act as the lead regulator of cryptocurrency, and some members of Congress have similarly sought to regulate cryptocurrency under the Commodity Futures Trading Commission.<sup>38</sup> Any regulations seeking to allow and govern the use of virtual currency in campaign finance must account for both cryptocurrency’s usage as a form of electronic cash, which differentiates it from other types of in-kind support, and the federal government’s intent to regulate it alongside securities and commodities.

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<sup>31</sup> 120 Cong. Rec. 7832 (1974) (statement of Rep. Boland).

<sup>32</sup> GAO report, *supra* note 13, at 8.

<sup>33</sup> As the FEC’s advisory opinion noted, “a bitcoin user’s real-life identify, IP address, and even country of operation, cannot be reliably traced to a real human by an auditor of ordinary technical skill.” FEC AO, *supra* note 6, at 2.

<sup>34</sup> See Tex. Elec. Code § 253.001; 1 Tex. Admin. Code § 22.3 (prohibiting contributions made in the name of or on behalf of another) *see also* Tex. Elec. Code § 253.155 (providing contribution limits for judicial races).

<sup>35</sup> *Id.* § 22.31 (prohibiting contributions and expenditures by “foreign nationals” who have not been granted permanent residence in the United States).

<sup>36</sup> INTERNAL REVENUE SERVICE, Notice 2014-21 (2014), <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

<sup>37</sup> See TEX. STATE SECURITIES BOARD, *The Investor’s Guide to Cryptocurrency Offerings* (accessed Nov. 7, 2022), <https://www.ssb.texas.gov/investors-guide-cryptocurrency-offerings>; *see also* Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SECURITIES AND EXCHANGE COMMISSION (Dec. 11, 2017), <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>.

<sup>38</sup> See Mark Bini and Joanna Howe, *Here’s Why the SEC Will Likely Be the Primary Cryptocurrency Cop*, Bloomberg Law (Oct. 17, 2022), <https://news.bloomberglaw.com/us-law-week/is-the-sec-the-new-crypto-sheriff-in-town>.

In light of the above considerations, we strongly recommend that the Commission adopt additional safeguards to ensure transactions are traceable and require more stringent reporting of any virtual currency receipts. Specifically, Texas should require virtual currency contributions be made through a U.S.-based third-party exchange or payment processor that is registered with the U.S. Department of Treasury, Financial Crimes Enforcement Network and utilizes KYC protocols. Additionally, Texas should clarify how virtual currency contributions are valued, including the reporting of all transactions and any gains or losses in value, and enact clear guidance regarding how committees should deal with illegal contributions.

This approach balances the need for heightened regulation of virtual currency with the interests of donors and political committees seeking to make and receive such contributions. The enhanced reporting requirements likewise would ensure that committees promptly report cryptocurrency receipts and disclose its value and source at the time of receipt and expenditure. Accordingly, we believe these protocols represent the best policies to address virtual currency contributions, consistent with the Texas Election Code and actions by the FEC and other states.<sup>39</sup>

#### **A. Recordkeeping & Contributor Information**

Under the Texas Election Code, candidates and treasurers of political committee “shall maintain a record of all reportable activity” containing all “information that is necessary for filing the reports required.”<sup>40</sup> This information includes, but is not limited to, their “bank statements (front and back), deposit slips, cancelled checks (front and back), receipts, invoices, bills, and ledgers of contributions and expenditures”<sup>41</sup> as necessary to comply with state law. The total amount of political contributions for reporting purposes includes “the balance of political contributions accepted and held in any online fundraising account” that the filer can control through actions including a withdrawal, expenditure, or transfer.<sup>42</sup>

Campaigns are required to use their “best effort” to “obtain, maintain, and report the information required” for reports regarding the identity of contributors.<sup>43</sup> The Commission has interpreted these recordkeeping duties to include the collection of information for each contribution received, including the date and amount of the contribution along with the name and address of its source, even if donations do not exceed the \$90 aggregate contribution reporting threshold.<sup>44</sup> For contributions of more than \$720, campaign committees must make their best effort to obtain additional information, including the donor’s occupation or job title and the full name of

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<sup>39</sup> When the FEC issued its bitcoin advisory opinion in 2014, three FEC commissioners indicated that they would have supported regulating bitcoin contributions like cash under federal election law. *See* Statement of Vice Chair Ann M. Ravel & Comm’rs. Steven T. Walther & Ellen L. Weintraub on Fed. Election Comm’n Advisory Op. 2014-02 (May 8, 2014), <https://www.fec.gov/files/legal/aos/2014-02/1256453.pdf>.

<sup>40</sup> Tex. Elec. Code § 254.001; *see also id.* § 254.031; 1 Tex. Admin Code § 20.18.

<sup>41</sup> 1 Tex. Admin. Code § 20.18.

<sup>42</sup> “Online fundraising account” is not defined in the regulations or in the statutes, but includes online accounts used to hold political contributions, including through services like GoFundMe. *See, e.g., In the Matter of Thomas A. “Tom” Harrison*, Tex. Ethics Comm’n, SC-21812377 (Apr. 10, 2020), *available at* [https://www.ethics.state.tx.us/data/enforcement/sworn\\_complaints/2018/31812377.pdf](https://www.ethics.state.tx.us/data/enforcement/sworn_complaints/2018/31812377.pdf).

Cryptocurrency is stored in a “wallet,” which is “similar to a virtual account.” Wallets use private keys (similar to a PIN or password) to restrict access to spending the virtual currency and can interface with blockchains for verification and transfer of the assets they hold. *See* AG’s Report, *supra* note 8, at 3-4.

<sup>43</sup> *See* Tex. Elec. Code § 254.0312(a).

<sup>44</sup> While most campaigns are not subject to contribution limits in Texas, limits for cash contributions are cumulative. Without accurate recordkeeping, a campaign is unable to assess whether a donor has met or exceeded cash contribution limits. *See* Tex. Ethics Comm. Op. No. 207 (1994); *see also* Tex. Elec. Code §§ 253.033 (prohibiting cash contributions exceeding \$100), 254.031 (setting the contribution threshold for reporting); 1 Tex. Admin. Code § 18.31 (adjusting the reporting threshold for inflation).

the donor's employer.<sup>45</sup> This type of recordkeeping helps to facilitate compliance as well as audits of political committees' financial activities.

The pseudo-anonymity of cryptocurrency transactions presents challenges to recordkeeping requirements under Texas law. To address these challenges, the Commission should require committees to accept only virtual currency transactions that follow KYC protocols, conducted through U.S. Treasury-registered service providers, and to collect additional information necessary to ensure compliance with all other recordkeeping requirements for in-kind contributions. As explained above, KYC protocols help ensure that cryptocurrency transactions can be accurately traced to the person who is truly making the cryptocurrency contribution. This limits circumvention of source and amount limitations, aids committees in complying with their recordkeeping and reporting obligations and enables easier identification and enforcement of violations.

Notably, the FEC addressed similar questions about recordkeeping in 2014. In its advisory opinion request, the FEC approved a bitcoin recipient's proposal to take specific measures to collect information required by federal law and to ensure the legality of bitcoin contributions.<sup>46</sup> That proposal chiefly involved providing "a unique linked address by which an individual may make a bitcoin contribution *only after* that contributor provides his or her name, physical address, and employer, and affirms that the contributed bitcoins are owned by him or her and that the contributor is not a foreign national."<sup>47</sup> The FEC concluded that this procedure fulfilled the PAC's legal duties under federal law to collect information about its contributors.<sup>48</sup>

Five states have followed the FEC's example in their regulation of cryptocurrency contributions,<sup>49</sup> and, more recently, states that allow cryptocurrency and virtual currency contributions to political committees have adopted additional security protocols. Most recently, California's Fair Political Practices Commission adopted regulations permitting in-kind cryptocurrency contributions to committees, provided the contribution was made and received through a cryptocurrency payment processor registered with the Treasury Department's Financial Crimes Enforcement Network and utilizes KYC.<sup>50</sup> California further requires liquidation of all cryptocurrency contributions upon receipt,<sup>51</sup> which limits the impact of cryptocurrency's inherent volatility on recipient committees' reporting obligations after receiving such a contribution.

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<sup>45</sup> Tex. Elec. Code § 254.0312 (setting the threshold for additional reporting at \$500); *see also* 1 Tex. Admin. Code § 18.31 at Fig. 2 (adjusting the additional reporting threshold to \$720 for contributions made under Tex. Elec. Code § 254.0312).

<sup>46</sup> MYL PAC Advisory Opinion Request re. Bitcoin contributions (Feb. 10, 2014), <https://www.fec.gov/files/legal/aos/2014-02/1251666.pdf>.

<sup>47</sup> FEC AO, *supra* note 6, at 5.

<sup>48</sup> *Id.*

<sup>49</sup> States that follow the FEC's guidance in their regulation of cryptocurrency contributions include California, Colorado, Iowa, Ohio, and Tennessee, which require a fair-market valuation of the virtual currency contribution and treat increases or decreases in value as income or an expenditure. *See Ehret, supra* note 7.

<sup>50</sup> 2 Cal. Code Regs. § 18421.2; *see also*, David Bainbridge and Zachary W. Norton, *Adoption of Proposed New Regulation 18421.2, Cryptocurrency Contributions*, CAL. FAIR POLITICAL PRACTICES COMM'N (July 11, 2022), available at <https://www.fppc.ca.gov/content/dam/fppc/NS-Documents/AgendaDocuments/General%20Items/2022/july/14.0-Adoption-Memo.pdf> (Staff memo outlining the FPPC's proposed regulation for cryptocurrency contributions to political committees prior to adoption); and Dave Bainbridge and Zachary W. Norton, *Cryptocurrency Regulation*, CAL. FAIR POLITICAL PRACTICES COMM'N (May 9, 2022), available at <https://www.fppc.ca.gov/content/dam/fppc/NS-Documents/AgendaDocuments/General%20Items/2022/may/6-Memo-crypto.pdf> (Staff memo providing background information regarding cryptocurrency, the current state of cryptocurrency campaign contributions in federal and state campaign finance regulations, and options for potential approaches to cryptocurrency campaign finance regulations in California).

<sup>51</sup> *Id.*

If the Commission allows committees to hold virtual currencies, as the Proposed Regulation would, the Commission should also consider requiring campaigns to maintain virtual currency accounts or wallets with Texas state-chartered banks. Since 2021, the Texas Department of Banking has affirmed that Texas state-chartered banks are permitted to provide customers with virtual currency custody services, in line with their historic role providing customers with “safekeeping and custody services for a variety of assets.”<sup>52</sup> Requiring committees to utilize Texas state-chartered banks provides additional regulatory oversight abilities to the state to ensure that committees are complying with the Election Code and relevant regulations.

## **B. Valuation**

The Proposed Regulation specifies that a virtual currency’s valuation is “the fair market value of the virtual currency upon receipt,”<sup>53</sup> rather than at the time the contribution is made. We agree with this approach; due to the volatility of the cryptocurrency market and exchange rates, cryptocurrency values can fluctuate substantially within short periods of time, and specifying that the value is determined “upon receipt” ensures clarity and consistency in assessing and reporting the value of cryptocurrency contributions.<sup>54</sup> In recognition of the medium’s volatility, the Commission should clarify in the final rule how committees should determine a cryptocurrency contribution’s fair market value and the prevailing rate of exchange at the time of receipt.

The public exchange rate of a particular cryptocurrency to U.S. dollars on a particular service provider offers an objective measure to determine both the fair market value of the cryptocurrency contribution and its prevailing rate of exchange. For example, in its 2014 advisory opinion, the FEC advised recipients to value bitcoin contributions based on the public exchange rate of bitcoin to U.S. dollars provided by the entity processing the bitcoin contribution.<sup>55</sup> If no exchange rate was given by the processing entity for the transaction, the FEC concluded that the PAC could rely on a “reasonable exchange rate of bitcoins for dollars” provided on a high-volume public exchange open to transactions in the U.S.<sup>56</sup>

By requiring virtual currency contributions to be made via Treasury-registered service providers that utilize KYC protocols, the Commission can reduce uncertainty regarding the exchange rate, as exchanges provide information regarding the current rate of exchange on that platform.<sup>57</sup> This approach provides greater clarity and transparency regarding the value of virtual currency contributions, in addition to the increased security and transparency provided by KYC protocols.

## **C. Reporting of Transactions**

The Proposed Regulation requires a political committee to report “a gain from the sale of virtual currency contributions on the appropriate schedule if the

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<sup>52</sup> See Charles G. Cooper, *Industry Notice 2021-03*, TEX. DEPT. OF BANKING (June 10, 2021), <https://www.dob.texas.gov/sites/default/files/files/news/Industrynotices/in2021-03.pdf>.

<sup>53</sup> This also reflects the current regulations governing valuation of in-kind contributions. See 1 Tex. Admin. Code § 20.51(a).

<sup>54</sup> See, e.g., Helene Braun, *Black Thursdays: Bitcoin’s 5 Worst Crashes*, CoinDesk (Oct. 24, 2022), <https://www.coindesk.com/layer2/2022/10/24/black-thursdays-bitcoins-five-worst-crashes/> (“After a 2021 that was arguably the most successful year for the crypto industry, the reckoning came swiftly . . . First came the crash of Terra, a blockchain with its own dollar-linked stablecoin, UST. The UST token was supposed to retain a value of \$1, but the price came unpegged – and soon traders also lost confidence in the blockchain’s native cryptocurrency, LUNA, whose price eventually would tumble 99% . . . Bitcoin lost nearly 37% in June alone, dropping from \$32,000 to below \$18,000”).

<sup>55</sup> FEC AO, *supra* note 6, at 6-7.

<sup>56</sup> FEC AO, *supra* note 6, at 7.

<sup>57</sup> IRS FAQ, *supra* note 3, at Q.26; see also, *How Does a Crypto Exchange Work?*, SoFi (Sept. 23, 2022), <https://www.sofi.com/learn/content/how-crypto-exchanges-work/>.

gain exceeds the reporting threshold set by Section 254.031(9) of the Election Code and amended by §18.31 of this title.”<sup>58</sup> We recommend some additional reporting requirements for gains and losses of value of virtual currency.

As the Proposed Regulation identifies, a committee’s receipt and the subsequent liquidation of cryptocurrency often will entail separate transactions: the initial receipt of the cryptocurrency from a donor, and the subsequent conversion of the cryptocurrency to U.S. dollars through an exchange. In records and reports, political committees should account for both transactions. The initial receipt of cryptocurrency should be treated as a direct in-kind contribution made by the donor; any fees deducted from the contribution by the transaction’s processor should not be subtracted from the total value of the contribution and should be reported as an expenditure.<sup>59</sup> Only the initial transaction should be attributable to the original donor as a contribution, as the donor has no control over the eventual value of a cryptocurrency contribution when the committee converts it to traditional currency.

While the current Proposed Regulation requires reporting of a gain in value if it exceeds the statutory threshold, we recommend that any changes in virtual currency value between receipt and liquidation or expenditure be reported in the committee’s regular reports.<sup>60</sup> Market volatility can result in both gains and losses for virtual currency holders that can affect a campaign’s overall balance sheet, regardless of whether such changes in value meet the reporting threshold, in a way that is not present with many other forms of in-kind contributions.<sup>61</sup> Reporting the current value of any virtual currency held by a campaign, as well as any earnings or losses realized upon the sale of a virtual currency, aligns with both the FEC’s 2014 advisory opinion<sup>62</sup> and the Commission’s current treatment of similar investments that can be readily converted to cash, including money market accounts, bonds, and certificates of deposit.<sup>63</sup>

Finally, the Commission should also set clear rules regarding use of virtual currency for expenditures, including for valuation of virtual currency at the time of expenditure. Because the Proposed Regulation does not require liquidation of virtual currency prior to making an expenditure,<sup>64</sup> committees may elect to make expenditures using virtual currency. We recommend the Commission require that, like virtual currency contributions, all virtual currency expenditures be made through a service provider registered with the U.S. Treasury and utilizing KYC protocols. This will assist committees in complying with expenditure reporting requirements<sup>65</sup> by providing a reliable valuation of the currency at the time of the transaction<sup>66</sup> and verification of the identity of the expenditure’s recipient.

#### **D. Refund of Illegal Contributions**

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<sup>58</sup> See 1 Tex. Admin. Code § 18.31 (Detailing the reporting thresholds for various committees and contributor categories).

<sup>59</sup> The 2014 FEC Advisory Opinion specifies this process for bitcoin contributions to political committees. FEC AO, *supra* note 6, at 9. Similarly, the Commission has previously specified that any fees deducted by a vendor or agent processing payment by credit card on behalf of a committee are *not* deducted from the total amount of each contribution. Tex. Ethics Comm. Op. No. 514 (Oct. 30, 2013).

<sup>60</sup> Current regulations require that when a committee accounts for political contributions in a report, the committee must include “the present value of any investments that can be readily converted to cash.” Investments “that can be readily converted to cash” include but are not limited to certificates of deposit, money market accounts, stocks, bonds, and treasury bills. 1 Tex. Admin. Code § 20.50(a)(3).

<sup>61</sup> See 1 Tex. Admin. Code § 18.31 (Adjustments to reporting thresholds).

<sup>62</sup> See FEC AO, *supra* note 6, at 8.

<sup>63</sup> *Supra* note 60.

<sup>64</sup> *Supra* notes 50 and 51.

<sup>65</sup> Tex. Elec. Code § 254.031(a)(3) (setting the expenditure reporting threshold at \$100); 1 Tex. Admin. Code § 18.31(a), at Fig. 1 (adjusting the expenditure reporting threshold to \$190).

<sup>66</sup> *Supra* note 57.

As part of its final rule, the Commission should consider detailing the procedure for committees to return illegal or, in the case of judicial elections, excessive cryptocurrency contributions. Many cryptocurrency transactions are irreversible, and it may be difficult or impossible for a political committee to return an illegal or excessive donations of cryptocurrency in a digital form.<sup>67</sup> Thus, the Commission should formulate regulatory guidelines for committees to refund or disgorge illegal contributions of cryptocurrency in an equivalent dollar amount, or in digital form if feasible.<sup>68</sup>

### Conclusion

We thank the Texas Ethics Commission for considering our recommendations for its final rule, and we applaud the agency's decision to address virtual currency contributions through the rulemaking process. We would be happy to answer questions or provide additional information to assist the Commission's development of virtual currency regulations.

Respectfully submitted,

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<sup>67</sup> Lansky, *supra* note 14, at 25.

<sup>68</sup> See FEC AO, *supra* note 6, at 6.

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