



Accepting Cryptocurrency as Payment for Legal Fees

Ethical and Practical Considerations

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In the early 1970s, the legal community grappled with whether to allow payment of legal fees by then-innovative means: the credit card.¹ Now, attorneys are faced with another cutting-edge method of paying legal fees: virtual currency, also known as cryptocurrency.

While most of us have at least heard of Bitcoin and Ethereum—the two most popular forms of cryptocurrency²—few attorneys are comfortable enough with the cryptocurrency concept to start accepting it as payment for legal services. Cryptocurrency is not money, and it is not issued or backed by any government. Cryptocurrency is a virtual asset only existing in electronic form. Coins are merely an entry on a virtual ledger that contains a chronological

record of all ownership changes in the coins making up the virtual currency. This ledger, known as the “blockchain,” is replicated on servers all over the world.³ The blockchain consists of a series of “blocks” with basic details regarding each transaction (including source, destination, and date/time), and is ever-expanding with each successive transaction. All transactions in the blockchain are verified and publicly viewable at <https://blockchain.info>.

Benefits of Accepting Cryptocurrency

Transacting business with cryptocurrency has several benefits. Payments are instantaneous. Thanks to blockchain verification, cryptocurrency transactions are transparent and less susceptible to fraud. There are no banking

fees, currency conversion fees, or credit card transaction fees (although some of the crypto exchanges do charge transaction fees). Thus, it is not surprising that cryptocurrency is gaining a foothold in the global economy as a common method of payment. As of January 2019, people held nearly \$130 billion in Bitcoin alone, with over 230,000 Bitcoin transactions processed each day.⁴

As more and more clients and prospective clients are using virtual currency, law firms need to evaluate whether they should join the trend by accepting virtual currency as payment for legal services. The option of paying in virtual currency offers clients considerable payment flexibility, particularly for international clients or tech clients who already use cryptocurrency as their preferred method of payment. Online directories are already directing potential clients to law firms that accept cryptocurrency.⁵

Ethical and Practical Challenges

Just like credit cards in the 1970s, the new frontier of cryptocurrency presents unique ethical and practical challenges for attorneys. The IRS classifies cryptocurrency as property, not currency.⁶ The Colorado Rules of Professional Conduct (Colo. RPC) allow attorneys to accept property in payment for services.⁷ Indeed, lawyers have received property in exchange for legal services for as long as lawyers have provided legal services.⁸ However, taking property from a client for fees is a business transaction with a client that may be subject to Colo. RPC 1.8(a) in a manner similar to acquiring an ownership interest in a client for fees.⁹ In addition, before accepting cryptocurrency as payment for legal services, attorneys will need to develop and implement plans to (1) mitigate volatility risk, (2) appropriately safeguard cryptocurrency held in trust for clients, (3) properly identify the payer of legal fees, and (4) meet the associated ethical challenges of doing business with a client.

Mitigating Volatility Risk

Cryptocurrency is notoriously volatile. For example, on November 12, 2017, a single Bitcoin was valued at \$5,953.85. Just over a month later (on December 16, 2017) the value skyrocketed

to an all-time high of \$19,190.16. Then one week later (on December 23, 2017) it plummeted to \$14,039.59. As of February 9, 2019, it was worth \$3,667.76—up in value by about 10% for the year.¹⁰ Given these wild swings, an attorney’s billing rate could be reasonable when the fee agreement is signed, but then unreasonably high (or unconscionably low) by the time the legal services are performed, billed, and paid. This raises at least two questions:

1. How can an attorney get paid in Bitcoin or other cryptocurrency without running afoul of Colo. RPC 1.5(a)’s prohibition on charging or collecting an unreasonable fee should the value increase dramatically shortly after payment of the fee?
2. Who will bear the potential risks and rewards of the volatility—the attorney or the client?

First, an attorney should not bill in terms of Bitcoin or other virtual currency, but rather continue to bill in U.S. dollars pursuant to the lawyer’s engagement letter with the client. Until cryptocurrency becomes much more stable, it should only be considered as a method of paying legal fees that have been billed in U.S. dollars. This would eliminate most of the volatility risk over the course of the law firm’s billing cycle and provide a basis for the test for the reasonableness of the fee.

Nevertheless, some volatility risk remains if the law firm does not immediately convert the cryptocurrency to U.S. dollars. The only formal ethics opinion to address this topic thus far was issued in Nebraska in 2017. It states that an attorney accepting cryptocurrency should convert the digital currency to U.S. dollars immediately upon receipt and credit the client’s account accordingly at the time of payment.¹¹ Even this guidance leaves several questions open:

- What constitutes “immediate?” If a payment is submitted after hours on a Friday, would it be too late to convert and deposit the funds on Monday morning? Given cryptocurrency volatility, the exchange rate could have dramatically changed by then. Is 24/7 staffing needed for law firms to “immediately” process cryptocurrency payments?

- What exchange rate applies? Is the applicable exchange rate based on the time of payment or the time of conversion?
- If there is appreciation or depreciation between the time of payment and the time of conversion, who bears that risk/benefit and who would be responsible for the attendant tax consequence?
- What exchange medium should be used, and who bears the transaction fees associated with the conversion?

These questions should all be discussed with the client at the outset and addressed in the engagement letter as described in more detail below.

Safeguarding Retainers and Escrowed Cryptocurrency

Even trickier is the issue of holding cryptocurrency in trust for a client—whether as a retainer or otherwise. Because cryptocurrency is considered property, not currency, cryptocurrencies cannot be deposited into a COLTAF account under Colo. RPC 1.15B. Instead, the law firm must find other means to keep its client’s cryptocurrency “appropriately safeguarded” under Colo. RPC 1.15A.

Most virtual currency is stored in digital wallets offered by online platforms such as Coinbase. However, theft via hacking is a substantial risk, as is the risk of losing the password needed to access virtual currency.¹² Compounding these problems, because cryptocurrency is decentralized and not regulated, there is no central bank, government, or FDIC-equivalent to insure against a loss.

Reasonable methods of safeguarding cryptocurrency for a client may include using more than one private key for access to cryptocurrency, or maintaining the digital wallet or private keys in a computer, flash drive, or other storage device that is not connected to the Internet (known as “cold storage”). Using cold storage makes the virtual currency less susceptible to hacking attempts,¹³ but if the physical wallet containing the keys is lost or destroyed, there is no way to recover the virtual currency associated with the lost keys.¹⁴

Given the volatility and security risks outlined above, it would be inadvisable to accept

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cryptocurrency as payment for a retainer to be drawn upon when fees are earned in the future, unless:

- the cryptocurrency is immediately converted to U.S. dollars upon its receipt,¹⁵ or
- the lawyer accepts the risk of gain or loss and security, and specifically addresses these (and other) issues in the engagement letter.

Where property is being paid to the lawyer in advance (similar to a retainer), Colorado lawyers must also consider the implications of *In the Matter of Sather*,¹⁶ regarding the circumstances under which a fee paid in advance may be considered earned and the reasonableness of that fee—generally judged at the time the property is earned by the lawyer, not when it is received by the lawyer if paid in advance. As stated in *Sather*,¹⁷ advance fees remain the

property of the client until earned by the lawyer, as does the appreciation (or loss) on property held by the lawyer.

Verifying the Payer's Identity

Colo. RPC 1.8(f) provides that

[a] lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6.

Attorneys accepting cryptocurrency as payment for legal services must be mindful of this rule because identifying the payer of cryptocurrency is not easy. Transactions in the blockchain contain certain pieces of identifying information, but the personal identity of the payer is not one of them. While it is possible to track identities through IP addresses, the identity of payers of cryptocurrency is relatively secret.¹⁸ In fact, criminals and money launderers are increasingly using cryptocurrencies to launder their dirty money.¹⁹ Accordingly, due to the anonymity of cryptocurrency payers, it may not be possible to know who is paying the bills on behalf of your client.²⁰

While most well-known payment processors such as Coinbase, Bitpay, and Circle require the disclosure of the user's identity when making a payment and require the payer to complete a "Know Your Client" form to use their service for payment, not all do so.²¹

Tax Consequences

The tax consequences of a lawyer accepting fiat currency in payment of legal fees or expenses is relatively simple. Any funds received are first applied to expenses, and the balance is income to the recipient lawyer or law firm.

Cryptocurrency, however, is property, as is a brace of mules, a share of growing crops, or any other item a client may use to barter for legal services. Where the lawyer receives the property at its then fair-value for fees, the transaction would constitute the sale of the property by the client (who would have to recognize gain or loss)

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and the purchase of property by the lawyer (who would recognize income and thereby establish the tax basis for the property). When the lawyer then converts the cryptocurrency (or other property) into cash, the lawyer must recognize gain or loss from the property, depending on the sale price. The gain or loss may be short-term or long-term, depending on the holding period.

Where the lawyer holds cryptocurrency (or any other bartered property) in "safekeeping" under Colo. RPC 1.15A, gains or losses on the property are not realized until the property is "sold" (i.e., exchanged for payment of fees). When held in trust, the property is the client's property; when used to pay fees (based on some agreed conversion rate), the client has "sold" property and must recognize gain or loss based on the dollar value of the fees paid and the client's basis in the cryptocurrency.

As with other assets, valuation is an issue with cryptocurrency. Different exchanges can list different rates for the same cryptocurrency. While well-established coins like Bitcoin or Ethereum are easier to value, lesser-known cryptocurrency can be much more difficult. Ultimately, law firms should work in U.S. dollars.

The Engagement Letter

Lawyers should consider the issues discussed above and other issues that will become relevant as the use of cryptocurrency further develops. If a lawyer and her firm choose to accept cryptocurrency as payment, the engagement letter becomes a very important tool to allocate the risks and rewards of the transaction and to establish compliance with the Colo. RPC. The engagement letter should express the client's understanding and informed consent to at least the following points:


1. The lawyer's acceptance of cryptocurrency as payment of fees (denominated in U.S. dollars), or the lawyer's agreement to accept cryptocurrency as payment of fees, constitutes a business transaction with a client subject to Colo. RPC 1.8(a).
2. The client is advised to consult with tax counsel regarding the intention to pay legal fees in cryptocurrency.
3. After the lawyer accepts the cryptocurrency for fees, it becomes the lawyer's property, the lawyer has the risk of gain or loss, and the lawyer makes the decision when and how to sell the cryptocurrency. Any gain recognized by the lawyer on the value will not be credited to the client's future fees. (The engagement letter should include the parameters for valuing the cryptocurrency, including identification of the exchange to be used, allocation of transaction fees, and the expected timing of the conversion. If the lawyer intends to convert the cryptocurrency into dollars promptly after receipt in payment of fees, that intention should be set forth in the engagement letter and the obligation of the client to make up any shortfall or to be entitled to any gain should be set forth.)
4. The client tendering cryptocurrency in payment of fees is responsible for the tax consequences to the client that occur upon the lawyer's acceptance of the cryptocurrency in payment of fees.

In addition, where the cryptocurrency is accepted for "safekeeping" under Colo. RPC 1.15A, the engagement letter should specify that the cryptocurrency remains the property of the client until earned by the lawyer—as does the

appreciation or loss on the cryptocurrency. It should also define who is responsible for the safekeeping, discuss the safekeeping mechanism(s), and allocate responsibility for security. The engagement letter should also

- allocate responsibility for storage costs and risk of loss—whether loss of value or actual loss of the property through hacking or loss of the key;
- specify that because property held for safekeeping under Colo. RPC 1.15A remains property of the client, the lawyer must sell the cryptocurrency at the client's request (to prevent market losses or otherwise), and specify the procedures to do so;
- stipulate that the lawyer must first ask the client to make a further deposit for unrecognized losses, where the lawyer wants to retain some ability to protect against downside losses on the property held for safekeeping. Otherwise (after a reasonable period of time) the lawyer is entitled to sell the cryptocurrency and retain the funds received in the lawyer's COLTAF account for the credit of the client;
- clearly allocate tax obligations resulting from the sale of the cryptocurrency held in safekeeping to the client or the use of the cryptocurrency to pay fees;
- identify the payer and mandate that the client advise the lawyer of any future changes of the information in the engagement letter; and
- address the issues that arise under Colo. RPC 1.8(f) and applicable anti-money laundering regulations, where the payer is a third party.

Conclusion

As cryptocurrency transactions gain traction throughout the United States and the rest of the world, law firms must start thinking about whether to offer their clients the option to pay legal fees in cryptocurrency. This is not a decision to be taken lightly, and it should be made only after due consideration of the ethical and practical considerations outlined in this article and others.²² 



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NOTES

1. See ABA Formal Op. 338 (Nov. 16, 1974) (permitting, for the first time, payment of legal services by credit card, provided the lawyer (1) warned clients about potential interest costs the client would have to bear, and (2) did not increase the legal fee to cover the lawyer's credit card processing charges).
2. As of February 2019, there were more than 2,100 cryptocurrencies. <https://coinmarketcap.com>.
3. See Grider, "Advancing and Implementing Blockchain in the Legal Industry," 47 *Colorado Lawyer* 6 (Dec. 2018).
4. Bragança, "Dipping Your Analog Toe into Digital Coins," *ABA Law Practice Magazine* (Jan. 2019), www.americanbar.org/groups/law_practice/publications/law_practice_magazine/2019/january-february/JF2019Braganca.
5. See, e.g., <http://spendbitcoins.com/places/c/lawyers>; <http://www.bitcoinattorney.info>.
6. IRS News Release, IRS Virtual Currency Guidance: Virtual Currency is Treated as Property for U.S. Federal Tax Purposes; General Rules for Property Transactions Apply, www.irs.gov/newsroom/irs-virtual-currency-guidance.
7. Colo. RPC 1.5, cmt. 4 ("a fee paid in property instead of money may be subject to the requirements of Rule 1.8(a) because such fees often have the essential qualities of a business transaction with the client").
8. See McLees, "Discounting and Bartering Legal Fees," 10 *J. Legal Profession* 189 (1985), www.law.ua.edu/pubs/jlp_files/issues_files/vol10/vol10art10.pdf.
9. CBA Ethics Comm. Formal Op. 109: Acquiring an Ownership Interest in a Client (2015).
10. <https://charts.bitcoin.com/btc/chart/price>.
11. Nebraska Ethics Advisory Opinion for Lawyers No. 17-03 (Sept. 11, 2017), <https://supremecourt.nebraska.gov/sites/default/files/ethics-opinions/Lawyer/17-03.pdf>.
12. See Sider and Yang, "Good News! You Are a Bitcoin Millionaire. Bad News! You Forgot Your Password," *Wall Street J.* (Dec. 19, 2017), www.wsj.com/articles/good-news-you-are-a-bitcoin-millionaire-bad-news-you-forgot-your-password-1513701480. Also, in February 2019 the news reported that the unexpected death of the 30-year-old owner of Canada's largest cryptocurrency exchange left GB£145 million of cryptocurrency locked in a digital wallet to which he reportedly had the only password. Cuthbertson, "Bitcoin: Millions of dollars of cryptocurrency 'lost' after man dies with only password," *MSN Money* (May 2, 2019), www.msn.com/en-gb/finance/other/millions-of-dollars-of-cryptocurrency-lost-after-man-dies-with-only-bitcoin-wallet-password/ar-BBTc2on.
13. Roldan, "A Bitcoin Primer for Attorneys," 44 *San Francisco Att'y* 40, 42 (Spring 2018), www.sfbar.org/forms/sfam/q12018/q1-2018-bitcoin.pdf.
14. *Id.*
15. See Nebraska Ethics Op. No. 17-03 ("if a lawyer receives bitcoins intended to reflect a retainer to be drawn upon when fees are earned in the future, the lawyer must immediately convert the bitcoins into U.S. dollars . . .").
16. *In the Matter of Sather*, 3 P.3d 403 (Colo. 2000).
17. *Id.* at 413.
18. Pooley and Lee, "Bits and Blocks: Navigating the Legal Landscape of the Blockchain Economy," 31 *Utah Bar J.* 54, 56 (May/June 2018), www.utahbar.org/wp-content/uploads/2018/05/May_June_2018_FINAL.pdf.
19. Scheck and Shifflett, "How Dirty Money Disappears Into the Black Hole of Cryptocurrency," *Wall Street J.* (Sept. 28, 2018), www.wsj.com/articles/how-dirty-money-disappears-into-the-black-hole-of-cryptocurrency-1538149743.
20. For a discussion of this, see Tenenbaum, "Cryptocurrencies attractive to criminals," *Tenenbaum Law* (Jan. 21, 2019), <https://tlawfirm.com/cryptocurrencies-attractive-to-criminals>.
21. *Id.*; Nebraska Ethics Op. No. 17-03.
22. See, e.g., Stark, "Why Lawyers Shouldn't Accept Fees in Cryptocurrency: Part 1," *Law 360* (June 13, 2018); Druck, "Bitcoin: Ready or Not," 75 *Bench & B. Minn.* 33 (June 2018); and Zimmerman, "Lawyers Accepting Bitcoin as Payment for Legal Services," 87 *J. Kan. B.A.* 16 (June 2018).