INITIAL COIN OFFERINGS: A PRIMER AND SUGGESTION OF IMPENDING ISSUES

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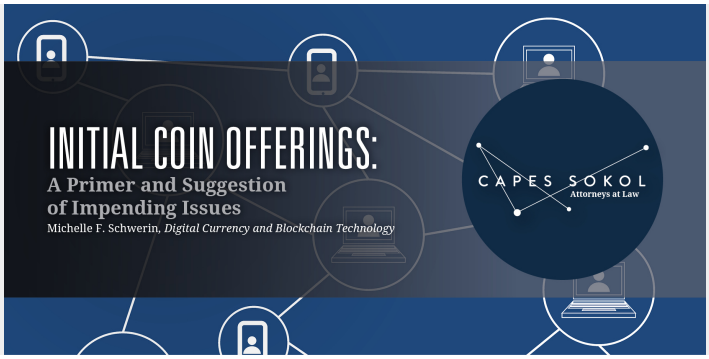

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Part One of Three: *This is the first of a three-part blog series. In this post, I will describe generally how an Initial Coin Offering (ICO) operates. Stay tuned for discussions in my second and third posts on how the Securities and Exchange Commission and the Internal Revenue Service might characterize and treat these ICOs.*

- **PART ONE**: Initial Coin Offerings: A Primer and Suggestion of Impending Issues
- **PART TWO**: Initial Coin Offerings: The Securities and Exchange Commission's View
- **PART THREE**: Initial Coin Offerings: Uncertain Tax Consequences

What is this "blockchain technology" thing anyway?

To understand Initial Coin Offerings ("ICOs") it is necessary to have at least a general understanding of how blockchain technology works. At a very general level, a blockchain network is a forum through which transactions are recognized and recorded in a decentralized, online community. The members of the blockchain network confirm the existence of a transaction on that network, and a ledger records each of those transactions in a chain of "blocks" -- hence the name: "blockchain."

Contrast blockchain with, for example, the traditional sale of a house, where value is transferred through a title company and is recorded by a governmental recorder of deeds. The blockchain community does not need a third-party title company through which funds are transferred or a third-party recorder of deeds to memorialize the transfer. Instead, the participants in the online blockchain community recognize that the transaction occurred, and a decentralized blockchain ledger records the transaction in a way that, theoretically, is permanent and unalterable. Every participant in the blockchain network has simultaneous access to the ledger and can observe, in close to real-time, transactions as they occur.

While virtual currency transactions are the most commonly thought of activities to occur using blockchain technology, the technology is pertinent to a host of other applications including – but certainly not limited to – real estate transactions, smart contracts (defining a contractual relationship using "if-then" business logic), and digital identity protection.

ICOs: Beyond Bitcoin

The process of building software applications based on blockchain technology is fundamentally no different than any other technology startup. These blockchain applications contemplate operating on a closed network (unlike the open network blockchains on which virtual currency is exchanged) through which the member participants observe and verify transactions. Consequently, in order to access the specific application blockchain network, a user must have entry as a participant.

Taking advantage of network exclusivity, some blockchain developers raise money to fund the development of their application by selling future rights to participate in the network. These developers issue a "utility coin" or "utility token" representing a future right to participate in the network in exchange for cash or virtual currency.

The most basic ICO grants the purchasers only a right to participate without conferring upon the purchaser any equity interest in the underlying software application. Moreover, even after selling coins or tokens, the developer might or might not have an obligation to actually produce an operational network.

ICOs raised more money in 2017 than early stage venture capital activity for internet companies. ICOs raised $1.2 billion (that's not a typo, that's billion with a "b") in December 2017 alone. There have already been more than 35 ICOs in 2018. The trend continues to grow.