Ten Blockchain and Digital Asset trends to expect in 2024 *and beyond*

BPM's Blockchain and Digital Assets Industry Group Leader, **Javier Salinas**, shares insights for the industry in 2024.

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Javier Salinas
Partner, Tax – Corporate International

Blockchain and Digital Asset Industry Group Leader

From advancements in technology to regulatory changes and shifts in market sentiment, the blockchain and digital asset industry continues to be a dynamic and evolving environment. Blockchain, the underlying technology behind Bitcoin and other digital assets, has expanded well beyond its initial applications.

Since its inception, blockchain technology has undergone continuous evolution, extending its reach beyond digital assets to provide a diverse range of novel solutions. Along its journey, it has played a transformative role in business operational models across various technological domains.

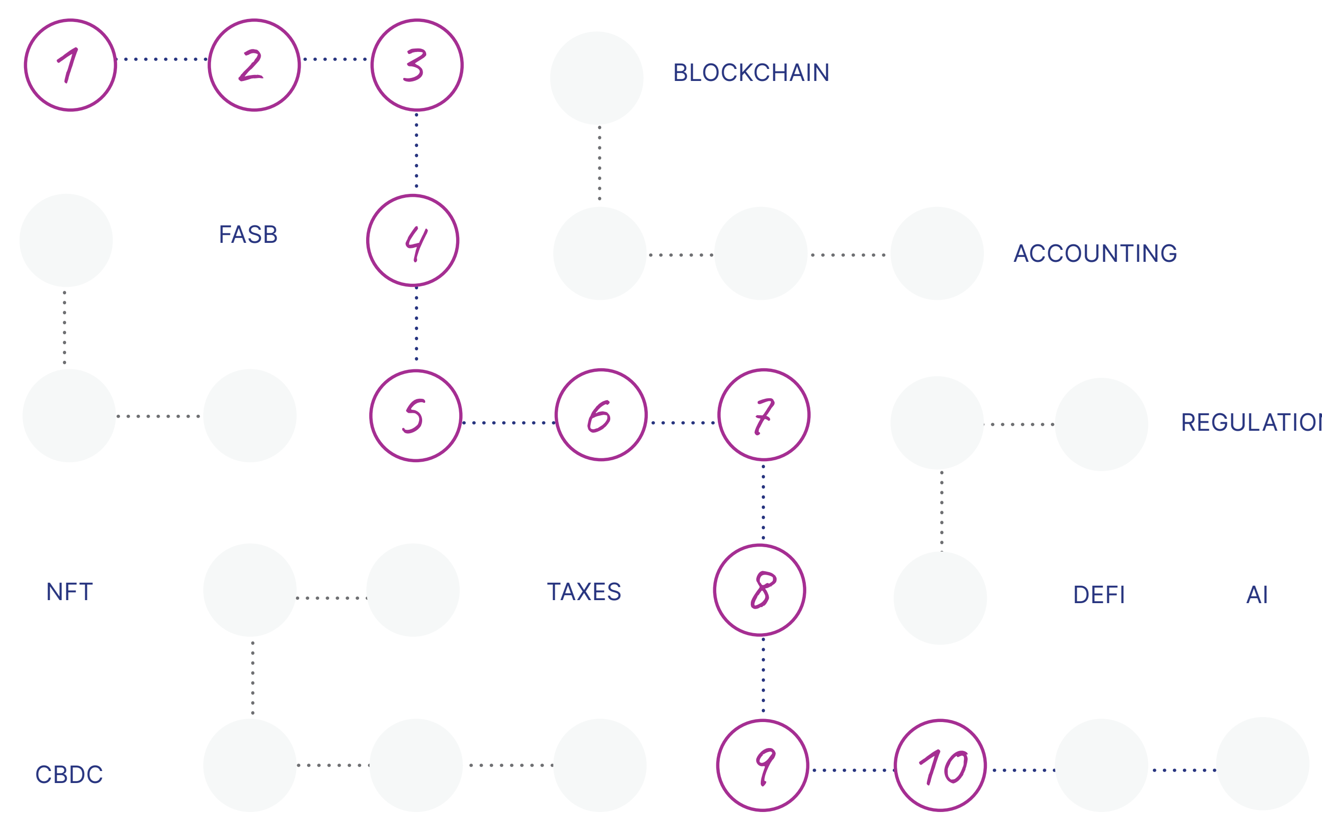
As more businesses recognize the benefits of blockchain, its adoption is set to accelerate, transforming the way we transact, secure data and manage digital assets. And as the use of blockchain continues to grow, it is expected to drive innovation, foster economic development and create new opportunities across various industries.

Ten Blockchain and Digital Assets trends to expect in 2024

With the cryptocurrency market in a state of constant transformation, the ongoing evolution of blockchain technology is expected to unlock fresh possibilities and reshape the future of diverse sectors in the coming years.

From the evolution of decentralized finance (DeFi)and the mainstream acceptance of non-fungible tokens (NFTs) to the integration of central bank digital currency (CBDCs) and the rise of regulatory scrutiny, the landscape for 2024 holds the potential for significant developments.

We explore ten trends that are expected to significantly impact the industry in the upcoming year.



1. Decentralized Finance (DeFi) evolution

The DeFi market is currently experiencing significant growth and innovation, and this is expected to continue in 2024. The use of decentralized exchanges (DEXs), which allow users to trade cryptocurrencies without a central authority, will continue to trend upwards, as will yield farming through DeFi protocols.

The total value locked within DeFi protocols has been on the rise through the end of 2023, reaching $50 billion[1], fueled in part by new inflows from participants seeking to benefit from attractive yields through staking, investing and lending activities. We anticipate the ongoing development of new DeFi use cases and applications, especially in the fintech P2P/B2B/P2B space.

Notwithstanding, the market is also likely to face challenges, such as regulatory uncertainty and security concerns, which could impact growth in the coming years.

DeFi market is currently experiencing significant
growth and innovation

$50 billion
Total value locked within DeFi protocols in 2023

2. Continued regulatory proposals and agency developments in the U.S. and abroad

From a U.S. federal perspective, although transactions involving digital assets have garnered considerable attention from federal agencies, formal rulemaking remains limited to date. The U.S. Securities and Exchange Commission (SEC) proposed a redefinition of “exchange” that could extend their purview over crypto exchanges, under the definition as a “communication protocols to bring together buyers and sellers of securities.”

Meanwhile at the state level, California and New York have each introduced a licensing regime to regulate the digital asset market in their states for businesses engaging in digital asset activities. In October 2023, California enacted the Digital Financial Assets Law (DFAL) to regulate companies engaged in digital asset activities in California.

It is a regulatory framework including licensing, disclosure, reporting and recordkeeping requirements, the establishment of examination and enforcement powers, and other requirements with significant implications for digital asset companies either based in California or out-of-state companies engaged in a digital asset business in California. The law becomes effective on July 1, 2025, and requires businesses engaged in digital asset activities to take measures to protect consumers.

In May 2023, New York announced a proposal from the State’s Attorney General, the Crypto Regulation, Protection, Transparency and Oversight (CRPTO) Act, aimed at tightening regulations on the digital asset industry. It would add another level of regulatory framework to the existing BitLicense regime in the state, and it could require many digital asset companies to reconsider and potentially restructure their existing business models within New York State.

On high-profile litigation matters, the recent settlement between the U.S. government and Binance highlights a positive development in the space. In this case, the U.S. government implicitly recognized that the blockchain and digital asset industry is here to stay when it did not seek to shut down the company. Following this settlement, the SEC has finally approved several spot bitcoin ETFs, some of which are trading on U.S. stock exchanges as of Thursday, January 11, 2024. This significant development allows investors to buy bitcoin and sell shares via conventional brokerages, potentially serving as a bridge between traditional finance and the world of crypto.

Generally speaking, state legislatures have become increasingly active in regulating the digital asset industry. As of 2023, nearly 80% of U.S. states have either passed or have legislative efforts underway that would impact the digital asset industry, mostly centered on customer protection.[2]

Meanwhile, there have been significant regulatory developments outside the U.S., such as the EU’s Market in Crypto Assets (MiCA) regulations; the UK’s plan to implement its first set of rules to regulate the crypto sector, requiring market participants to be authorized before they can offer services to consumers; Hong Kong’s guidelines for virtual asset trading platform operators; Dubai’s regulations on virtual asset activity; and Australia’s recent request for public comments on digital asset platform regulations. These developments help provide much-needed structure for businesses operating in the industry while exacerbating the uncertainty and challenges of operating in the U.S. market.

3. Growth of tokenization of real-world assets (RWAs)

The tokenization of RWAs, such as real estate, stocks and commodities, is expected to grow in prominence in 2024. According to a Bernstein report[3], tokenization represents a $5 trillion opportunity in the next five years. This trend involves the process of fragmenting an asset into digital tokens that represent the underlying property with all its rights and obligations, allowing for greater liquidity and accessibility.

Investors can diversify their portfolios by holding fractions of high-value assets, creating opportunities for fractional ownership and easier trading. As a recent report from the Federal Reserve notes, "Among the benefits of tokenization, lowering barriers to entry into otherwise inaccessible markets and improving the liquidity of such market are the most prominent."

The coming years will likely be dominated by the widespread tokenization of RWAs, with traditional financial institutions and fintech enterprises actively getting involved in this transformative process. As of November 2023, UK regulators began exploring a framework to allow asset managers to use tokenization with common asset classes.

An asset can be fragmented into digital tokens

$5 trillion

Tokenization opportunity in the next five years.

4. Proliferation of non-fungible tokens (NFTs)

NFTs gained widespread attention in 2021 and 2022, and their incorporation into mainstream culture is projected to escalate in the upcoming years. We can anticipate the emergence of NFTs across diverse industries, including sports, art, gaming, music and real estate. The creation of unique digital assets is poised to captivate the interest of creators and collectors alike, presenting novel income avenues for artists and pioneering investment opportunities for enthusiasts.

On matters of taxation, the IRS plans to issue guidance on the treatment of certain NFTs as collectibles under Section 408(m) of the Internal Revenue Code (IRC). This treatment is also relevant for other purposes of the IRC, including the long-term capital gains tax rate (28%) assessed on the sale or exchange of a collectible that is a capital asset held for more than one year.

Early in 2023, the IRS Office of Chief Counsel issued a memorandum indicating that taxpayers would need to obtain a qualified appraisal to be eligible for deductions for charitable contributions of digital assets that exceed a $5,000 threshold. It is worth highlighting that a value reported on a cryptocurrency exchange to value the charitable contribution deduction does not satisfy the qualified appraisal requirement.

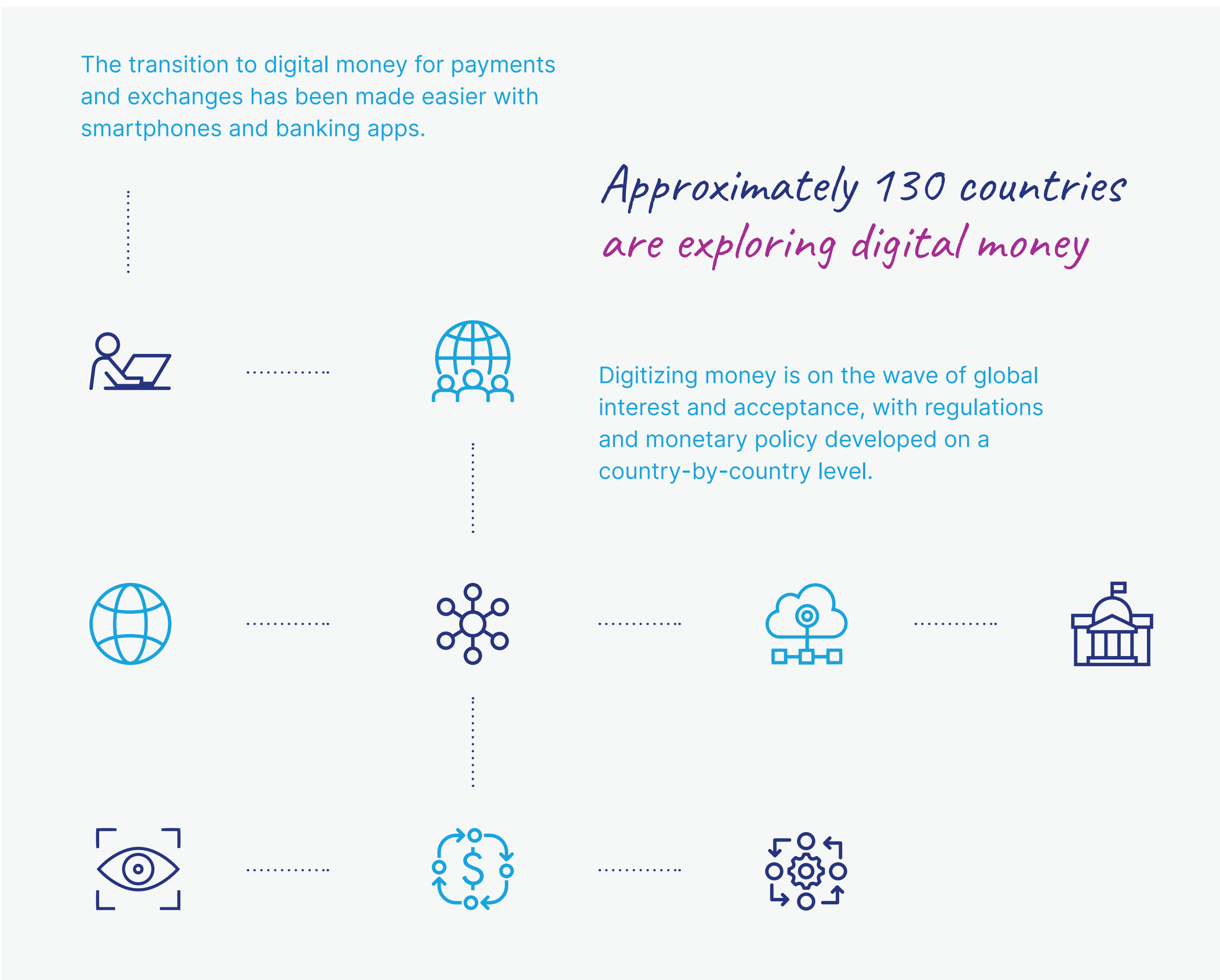
The increased use of NFTs across industries, as noted above, coupled with this and potentially additional IRS guidance, will make it critical for individuals and digital asset companies to navigate developments in tax rules and plan for how they may be impacted.

Top gaming companies are incorporating NFTs, such as marketplaces allowing players to buy, sell and truly own in-game assets, and staking systems allowing participation in the development and promotion of unique gaming aspects.

5. Central bank digital currencies (CBDCs)

Central Bank Digital Currencies (CBDCs), which represent the digital version of a country's official currency, will reach new milestones in 2024. The European Central Bank plans to launch a digital euro within a few years; China is trialing a digital yuan; India is planning a pilot program; and approximately 130 countries, representing 98% of the global economy, are exploring digital money.

These digital currencies aim to advance financial inclusivity, reduce transaction costs and provide governments with more monetary stability, especially in emerging markets where traditional financial infrastructures are absent or ineffective. Countries currently exploring the launch of their own CBDCs seek partnerships with blockchain technology and IT security companies, registered financial institutions, and fintech enterprises.

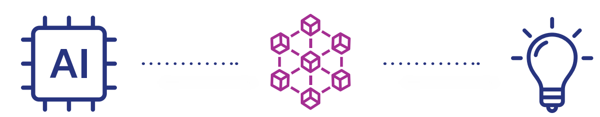


6. Blockchain and artificial intelligence (AI) convergence

The integration of AI and blockchain technology will gain more attention in 2024. The collaboration of these two technologies has the potential to generate significant benefits and innovations. By combining AI and blockchain, a new wave of applications emerges, capitalizing on the productivity gains facilitated by AI and leveraging the security and transparency inherent in blockchain.

This convergence has the potential to introduce innovative solutions, fostering improved efficiency, trust and accountability across diverse sectors such as healthcare, energy, social impact, agriculture and urban planning, to name a few. A real use case, as an example, involved using satellite imagery to collect data to verify a farmer's agriculture plot posted as tokenized collateral on a loan.

Of course, public policy that encourages responsible growth, provides guidance and minimizes risks will be key for these technologies to develop in a positive manner while mitigating exposure to unethical or criminal uses. More debate on these issues will take place in the coming year.



blockchain + artificial intelligence = benefits and innovations

7. Enterprise blockchain adoption

Look for enterprises to increase investment in blockchain technology to take advantage of improved transparency, increased security, streamlined operations and cost reduction. Numerous businesses have embraced blockchain technology to optimize their operations.

Also, consider the benefit to financial institutions that implement blockchain-based payment solutions, resulting in cost reductions and accelerated transactions using multi-bank shared ledgers.

The technology's tamper-proof nature, recording every transaction and data piece in an immutable block visible to the entire network, reduces fraud and fosters trust. This makes blockchain a game-changer in sectors such as finance and supply chain management. In 2024, we anticipate a surge in blockchain enterprise adoption, as companies increasingly recognize the potential of blockchain to enhance their operations.

Tracking your food to its source can take
2.2 seconds with blockchain

A major retailer, for example, had an internal team trace a package of fruit to the source. It took almost seven days of work. After implementing blockchain technology for the same search, which allows the retailer to trace the inventory and all related transactions via distributed ledger technology in a matter of seconds. In fact, the retailer traced the fruit stored in its U.S. stores within 2.2 seconds[4].

8. Sustainability and blockchains

Concerns about energy consumption and the environmental impact of blockchain, particularly proof-of-work (PoW) consensus mechanisms, will drive the development of more eco-friendly alternatives and sustainable practices. Several blockchain networks are shifting towards energy-efficient consensus mechanisms to alleviate the environmental impact of blockchain technology. This includes transitioning to proof-of-stake (PoS) consensus mechanisms or implementing Layer 2 solutions for scalability and minimizing the carbon footprint.

For example, Ethereum experienced a major upgrade to Ethereum 2.0, where the consensus mechanism was shifted from PoW to PoS, resulting in a significant decrease in energy consumption. Establishing Ethereum Layer 2 to address the high gas fees required to carry out each transaction allows the processing of transactions off the main chain and verifies transactions in batches, enhancing scalability with lower processing power.

President Biden's fiscal year 2024 budget proposes to impose a Digital Asset Mining Excise (DAME) tax, subjecting digital asset miners to a 30% tax on electricity to account for the high electricity use. If passed, this will be phased in over a three-year period, effective January 2024.[5] As global concerns over climate change continue to rise in 2024, sustainability will continue to be a significant consideration in the development of blockchain solutions.

9. Implementation of tax reporting standards

While tax administrations have been quieter than financial regulators, they have been actively working behind the scenes to introduce reporting standards for digital assets, with the aim of boosting transparency within the industry. We highlight three tax reporting standards for illustration.

The EU's Directive on Administrative Cooperation 8 (DAC8)

DAC8 is designed to complement the recently implemented Markets in Crypto-assets (MiCA) regulation and anti-money laundering rules. These rules will provide the conditions for access to the EU market for crypto assets, replacing existing national rules governing issuance, trading and custody of such assets.

The OECD's Crypto-Asset Reporting Framework (CARF)

The CARF stands as a global tax transparency framework facilitating the automatic exchange of tax information related to crypto-asset transactions. CARF imposes Common Reporting Standard (CRS)-style due diligence requirements on reporting crypto-asset service providers (CASPs), coupled with detailed reporting mandates for crypto-asset transactions.

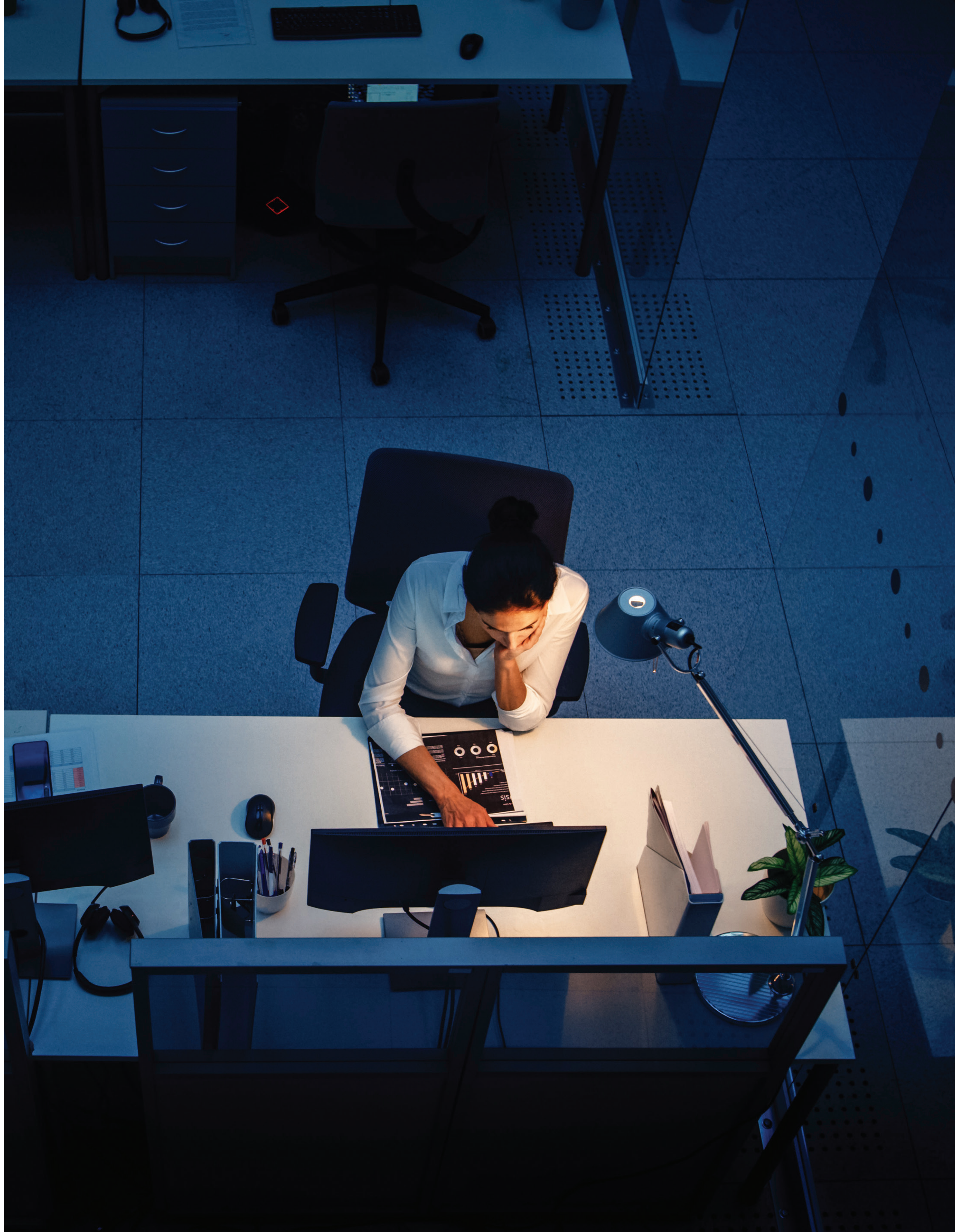
The OECD is currently in the process of developing an implementation package. Additional guidance is anticipated to be released in the coming years to ensure the effective implementation of CARF by reporting CASPs and participating jurisdictions.

The U.S.'s recently proposed rules for digital brokers

On August 25, 2023, the U.S. Internal Revenue Service (IRS) issued comprehensive proposed regulations regarding the information reporting of digital assets, aiming to align the tax reporting for digital assets with that of other types of assets.

The detailed and extraterritorial nature of the proposed rules would require domestic and international exchanges, as well as various types of brokers facilitating digital asset sales, to (i) gather identifying information from their customers, and (ii) report trading activities to both the IRS and U.S. customers, utilizing a new Form 1099-DA, which is set to be issued soon. Under the proposed regulations, brokers are mandated to commence reporting information on sales and exchanges of digital assets in the year 2026, covering transactions from the year 2025.

Additional guidance is anticipated in the upcoming year due to the provisional nature of these rules, as the IRS will need to review and consider comments from stakeholders. Though regulatory developments concerning digital assets vary across jurisdictions globally, expected trends indicate information sharing will be more coordinated and will likely see fewer challenges to implementation among U.S. tax authorities and other tax administrations around the globe.



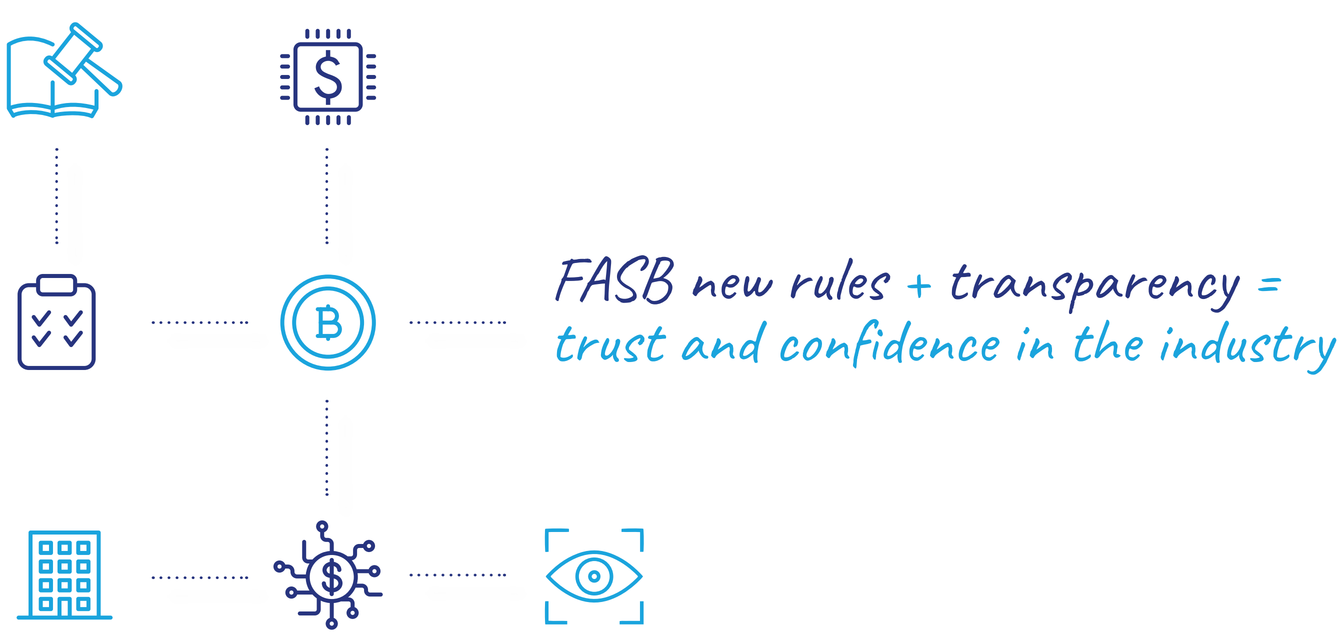
10. Developments in accounting rules for digital assets

In December 2023, the Financial Accounting Standards Board (FASB) announced new rules that will require companies to account for cryptocurrencies like Bitcoin at fair value. FASB adopted the new rules unanimously and will take effect after December 15, 2024, although companies will be permitted to adopt them earlier for financial statements that have not yet been issued. This is a significant development, considering no specific U.S. accounting rule has so far addressed how companies need to recognize and measure the digital currencies they own.

Prior to these rules, cryptocurrency was accounted for as an intangible asset. The consequence of this was that if the price went lower than what companies bought it for, they had to take an impairment charge on their books, even if they didn't sell. And if the price increased, there would be no benefit to recording on the books unless they sold.

Now, with fair value accounting, periodically (i.e., every quarter), companies can report the unrealized gains and losses to get an actual benefit on their books if the price of the asset increases (without having to sell to capture it). This could make companies more likely to add digital assets to their balance sheet and become long-term holders as they can report the appreciation without having to sell anything. Likewise, this increased transparency should foster greater trust and confidence in the industry, facilitating the ability of investors to make informed investment and capital allocation decisions.

These standards help create safeguards and confidence in a fast-developing industry, which may likely lead to increased involvement of users and investors. In response, we may see increased efforts to establish additional guidance across the industry with the involvement of various stakeholders.



Other developments helped foster this trend of developing standard practices, such as the Staff Accounting Bulletin (SAB) No. 121, issued by the SEC in March 2022, which provided reporting guidance for entities that safeguard digital assets. The SEC issued the guidance due to the increase in the number of entities that provide custodial services and the unique technological, legal and regulatory risks and uncertainties specific to safeguarding crypto assets. A custodial entity responsible for safeguarding cryptocurrencies for its users should report custodied cryptocurrencies as liabilities on the balance sheet and simultaneously recognize a corresponding asset.

BPM has served as an advisor to investors and other stakeholders in digital assets for nearly ten years. In that time, the Blockchain and Digital Asset Industry Group established itself as a leading provider of audit, tax and advisory services to the industry.

BPM is here to help with all services relevant to investors and companies involved with blockchain and digital platforms and assets, including global tax structuring and transfer pricing, financial statement audits, valuations, R&D tax credits and incentives, IT security services (ISO Advisory, IT Security, IT Security and Compliance, Security Operations Center), and cryptocurrency and token technical accounting, tax and reporting, among others.

Source:

[1] DeFiLlama: https://defillama.com/

[2] CA law - https://dfpi.ca.gov/dfal/#:~:text=The%20DFAL%20prohibits%20an%20entity,such%20as%20a%20crypto%20asset; NY proposal - https://ag.ny.gov/press-release/2023/attorney-general-james-proposes-nation-leading-regulations-cryptocurrency; https://www.ncsl.org/financial-services/cryptocurrency-2023-legislation

[3] https://www.coindesk.com/business/2023/06/20/tokenization-could-be-a-5t-opportunity-led-by-stablecoins-and-cbdcs-bernstein/

[4] https://tech.walmart.com/content/walmart-global-tech/en_us/news/articles/blockchain-in-the-food-supply-chain.html; https://www.jpmorgan.com/onyx/coin-system

[5] https://www.iwf.org/2023/05/16/white-house-dame-tax-will-hamper-crypto-mining/; https://www.whitehouse.gov/cea/written-materials/2023/05/02/cost-of-cryptomining-dame-tax/

Contact us

To learn more about how we can help your business, contact one of our practice leaders today.

Javier Salinas

Partner, Tax – Corporate International
Blockchain and Digital Assets Industry Group Leader

jsalinas@bpm.com

Abraham Tordjman

Director – International Tax

atordjman@bpm.com

bpm

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