
THE TAXATION OF BITCOIN: HOW THE IRS VIEWS CRYPTOCURRENCIES

*Deidre A. Liedel**

ABSTRACT

Cryptocurrencies such as Bitcoin have gained prominence since they were first introduced in 2008. While cryptocurrencies have grown in use by consumers and business, government regulators such as the Internal Revenue Service have been slower to respond to this technological creation. It is important to understand how the IRS views cryptocurrencies, so individuals and businesses can properly report their use of cryptocurrencies in transactions. The IRS has determined that cryptocurrencies will be treated as property, with all that entails including tracking basis, determining market value of transactions, and reporting gains or losses.

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* Deidre Liedel is an attorney and CPA and currently teaches at the University of Toledo College of Business and Innovation. She received her J.D. at the University of Toledo College of Law in 1998. The author thanks Dustin Miller for his contribution as a research assistant and Peggy Ery for her technical assistance.

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I. INTRODUCTION

The U.S. financial system has seen many changes since the economy developed beyond a barter economy several centuries ago. While we have not moved completely beyond a barter economy,¹ currency is used and exchanged in the vast majority of transactions for goods and services. Beyond the use of currency, the banking industry has taken steps to make spending money easier. The use of checks in the United States dates back to 1681, and money transfers were introduced by Western Union in 1871.²

1. Natasha Burton, *Bartering in the Modern Day: How People Are Swapping Skills and Services . . . For Free*, FORBES (July 20, 2015), <https://www.forbes.com/sites/learnvest/2015/07/20/bartering-in-the-modern-day-how-people-are-swapping-skills-and-services-for-free/#4b5813e517ed>.

2. See AM. BANKERS ASS'N, ABA TOOLBOX: CHECK 21 TOOLBOX 10 (2004), <https://www.aba.com/aba/toolbox/check21/Check21Toolbox.pdf> (stating that the first checks in the United States were used in 1681); Jeffrey L. Covell, *Western Union Financial Services, Inc.*, ENCYCLOPEDIA.COM, <http://www.encyclopedia.com/social-sciences-and-law/economics-business-and-labor/businesses-and-occupations/western-union> (last visited Aug. 24, 2017) (stating that wire transfer technology was first introduced in 1871).

These tools helped the economy grow and flourish because they made it easier for consumers to spend money.

In the current economy, the use of checks and money transfers has given way to credit cards, debit cards, PayPal, and other payment methods such as Apple Pay, Google Pay, and proprietary store options. These alternative payment methods are based on U.S. currency and provide a new level of convenience.³ However, technology moved beyond currency-based payment methods with the development of cryptocurrency. Cryptocurrency is “a digital currency or decentralized system of exchange that uses advanced cryptography for security.”⁴ In layman’s terms, cryptocurrency is a pseudonymous digital payment system.

While Bitcoin is the most well-known cryptocurrency, there are over 850 active digital currencies.⁵ Although it does fluctuate, sometimes significantly, Bitcoin alone has a daily transaction volume of \$50 million, with peaks of \$500 million⁶ and market capitalization of almost \$50 billion.⁷ Cryptocurrencies as a whole have a market capitalization of more than \$100 billion,⁸ indicating Bitcoin is by far the largest. The development and success of Bitcoin has prompted questions as to how Bitcoin and other cryptocurrencies should be treated by the Internal Revenue Service.⁹

This Article first reviews the history of cryptocurrencies, before detailing the IRS position as stated in Notice 2014-21, in order to understand the approach the IRS has taken with cryptocurrencies.¹⁰ This Article also discusses the perspective of several federal agencies that have addressed

3. See Gabriel Hubert, *A Guide to Payment Methods*, STRIPE (July 10, 2017), <https://stripe.com/payments/payment-methods-guide>.

4. *Cryptocurrency*, DICTIONARY.COM, <http://www.dictionary.com/browse/cryptocurrency?s=t> (last visited Aug. 24, 2017).

5. *Cryptocurrency Market Capitalizations: All Coins*, COINMARKETCAP (Dec. 19, 2017, 1:46 AM), <https://coinmarketcap.com/currencies/views/all/> (listing all current digital currencies).

6. See *USD Exchange Trade Volume*, BLOCKCHAIN, <https://blockchain.info/charts/trade-volume?timespan=all> (last visited Aug. 24, 2017).

7. *CryptoCurrency Market Capitalizations: Bitcoin*, COINMARKETCAP, <https://coinmarketcap.com/currencies/bitcoin/> (last visited Aug. 24, 2017).

8. *Id.*

9. See, e.g., Richard Rubin & Carter Dougherty, *Bitcoin Tax Rules Needed for Clarity*, FUTURES (Jan. 9, 2014), <https://www.futuresmag.com/2014/01/09/bitcoin-tax-rules-needed-clarity>.

10. See *infra* Part II.

cryptocurrencies, as well as how federal courts have classified cryptocurrencies in a variety of legal cases.¹¹ Next, a review of state and international treatment of Bitcoin, including a look at how the accounting industry has begun to look at cryptocurrencies.¹² Finally, this Article conducts a review of the conflicting judicial and regulatory treatment of cryptocurrencies.¹³

II. BRIEF OVERVIEW OF CRYPTOCURRENCIES¹⁴

Bitcoin was the first cryptocurrency, the protocol for which was developed and published in 2008 under the pseudonym of Satoshi Nakamoto.¹⁵ Prior to Nakamoto's invention, transferring money online required a trusted third-party intermediary, such as a credit card processor or PayPal.¹⁶ Any system without this third-party intermediary to maintain a ledger of transactions (i.e., subtract the balance from the sender's account and add it to the receiver's account) meant digital currency could be spent twice or transactions could be altered,¹⁷ making such digital currency unreliable and worthless. Bitcoin addressed this issue with what is called a blockchain and created a decentralized peer-to-peer payment network.¹⁸ "The blockchain is . . . an incorruptible digital ledger of economic transactions that can be programmed to record not just financial transactions but virtually everything of value"¹⁹ It ensures that digital money used in a transaction cannot be spent twice²⁰ nor balances retroactively edited.²¹

11. *See infra* Parts III, IV.

12. *See infra* Part V.

13. *See infra* Part VI.

14. "Bitcoin" is often used interchangeably with "cryptocurrency." However, Bitcoin is actually a form of a cryptocurrency and will be distinguished as such in this Article.

15. JERRY BRITO & ANDREA CASTILLO, BITCOIN: A PRIMER FOR POLICYMAKERS 3 (2013), https://www.mercatus.org/system/files/Brito_BitcoinPrimer.pdf.

16. *Id.*

17. *Id.* at 3–4.

18. *Id.* at 4.

19. Don Tapscott, *SXSW Preview: What's the Next Generation Internet? Surprise: It's All About the Blockchain!*, LINKEDIN (Mar. 12, 2015), <https://www.linkedin.com/pulse/whats-next-generation-internet-surprise-its-all-don-tapscott>.

20. BRITO & CASTILLO, *supra* note 15, at 4.

21. Derek A. Dion, Note, *I'll Gladly Trade You Two Bits on Tuesday for a Byte Today: Bitcoin, Regulating Fraud in the E-Conomy of Hacker-Cash*, 2013 U. ILL. J.L. TECH. & POL'Y 165, 168 (2013).

*A. Technical Aspects*²²

Ledgers have been the foundation of accounting for centuries.²³ Cryptocurrencies have expanded the definition and use of the accounting ledger by using a distributed ledger.²⁴ A commentator notes, “[A] distributed ledger is a database held and updated independently by each participant (or node) in a large network.”²⁵ Within the ledger system, each user has an account where transactions are posted via an entry in the ledger—a collection of these entries is a “block” in the “blockchain.”²⁶

To achieve a secure transaction ecosystem, cryptocurrencies use public-key cryptography, which requires every user to have both a public key and a private (or secret) key.²⁷ When cryptocurrencies are used in a transaction, the sender identifies the receiver by the receiver’s public key, while signing the transaction with the sender’s private key and a unique transaction number.²⁸ The proposed transaction is submitted to the decentralized network, and upon consensus, it is then added to the blockchain of the cryptocurrency with these keys.²⁹ Thus confirming the transfer of cryptocurrency from sender to receiver and ensuring that the same units cannot be transferred again.³⁰

Users or owners of a cryptocurrency can store their units two ways. Users can choose to store units on a computer, sometimes referred to as “cold storage.”³¹ This method does have risk, because if you lose access to your computer and its digital contents, there is not another way to access your cryptocurrency.³² The second option is to use an exchange, similar to a

22. Acknowledging that this is an Article focused on Bitcoin and the IRS, I will minimize the technical aspects of Bitcoin.

23. Nolan Bauerle, *What Is a Distributed Ledger?*, COINDESK, <https://www.coindesk.com/information/what-is-a-distributed-ledger/> (last visited Aug. 24, 2017).

24. *See id.*

25. *Id.*

26. BRITO & CASTILLO, *supra* note 15, at 5.

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. Alexandr Nellson, *How to Store Bitcoins and Other Cryptocurrencies Properly*, MEDIUM (Feb. 24, 2017), <https://medium.com/@nellsonx/how-to-properly-store-bitcoins-and-other-cryptocurrencies-14e0db1910d>.

32. *Id.*

stock exchange, where units can be digitally stored in a “wallet” or account.³³ Each different cryptocurrency may have numerous exchanges where users can exchange government-backed legal tender or fiat currency³⁴ for cryptocurrency units or vice versa, or the units can be exchanged for goods and services.³⁵ Cryptocurrency exchanges are not regulated like banks³⁶ or publicly traded stocks,³⁷ and the exchanges can be very volatile.³⁸

1. *Benefits of Cryptocurrencies*

Cryptocurrencies, derived from the innovation of the blockchain, can function as a reliable online payment system with several benefits. Cryptocurrencies have a level of pseudonymity that is not found in other online payment methods,³⁹ an important feature both for those seeking privacy and organizations that require it. Through cryptocurrencies’ implementation of the blockchain, users are not identified by name, bank account, social security number, or other method.⁴⁰ However, most cryptocurrencies do not have complete anonymity, as the history of blockchain transactions is public by nature, and the activity of any specific user, based on the user ID, is traceable.⁴¹

33. Dion, *supra* note 21, at 167.

34. *Definition of Fiat Money*, FIN. TIMES, <http://lexicon.ft.com/Term?term=fiat-money> (last visited Sept. 1, 2017).

35. See Elise Moreau, *6 Major Retailers and Services That Accept Bitcoin*, LIFEWIRE (last updated Dec. 18, 2017), <https://www.lifewire.com/big-sites-that-accept-bitcoin-payments-3485965>; *Where Can I Spend Bitcoin?*, COINBASE (Dec. 18, 2017), <https://support.coinbase.com/customer/portal/articles/1834716-where-can-i-spend-bitcoins->.

36. The Fed. Reserve Sys. Purposes & Functions, *Function: Supervising and Regulating Financial Institutions and Activities*, BD. GOVERNORS FED. RES. https://www.federalreserve.gov/aboutthefed/files/pf_5.pdf (last visited Sept. 2, 2017).

37. See *id.* (discussing the regulation of banks); *Fast Answers: The Laws that Govern the Securities Industry*, U.S. SEC (Oct. 1, 2013), <https://www.sec.gov/answers/about-lawsshtml.html> (discussing the regulation of the securities industry); see also Tama Churchouse, *The SEC is Finally Starting to Regulate Bitcoin and Other Cryptocurrencies*, BUS. INSIDER (July 29, 2017), <http://www.businessinsider.com/bitcoin-price-security-equity-sec-2017-7>.

38. Dani Burger, *Bitcoin Has Become So Volatile It Looks Like an ETF on Steroids*, BLOOMBERG (June 29, 2017), <https://www.bloomberg.com/news/articles/2017-06-29/bitcoin-s-become-so-volatile-that-it-looks-like-a-steroidal-etf>.

39. See BRITO & CASTILLO, *supra* note 15, at 7–8.

40. *Id.* at 8.

41. *Id.*

Despite this pseudonymity, there have been efforts to identify cryptocurrency users through their accounts on third-party exchanges. The IRS has attempted to obtain the identities of all 1.5 million users of the largest U.S. Bitcoin exchange, Coinbase.⁴² After receiving critical inquiries from Congress⁴³ and opposition from both Coinbase itself and a Coinbase user,⁴⁴ the IRS limited its inquiry only to those “who have conducted ‘at least the equivalent of \$20,000 in any one transaction type (buy, sell, send, or receive) in any one year during the 2013-2015 period,’”⁴⁵ using the reporting thresholds of Internal Revenue Code (IRC) § 6050W, which requires all payment-processing companies such as PayPal to report certain information to the IRS regarding payments that were processed in a calendar year.⁴⁶ Coinbase has not yet responded to the limited inquiry.⁴⁷

Cryptocurrencies can function as a medium of exchange with lower transaction costs than a typical paper currency with digital aspects. For example, the average cost to print a U.S. currency note (regardless of denomination) is \$0.10267 per note.⁴⁸ Beyond the cost of the actual currency is the cost of the banking industry itself, so that paper currency can function. Additional costs of the system include environmental costs, socioeconomic costs, corruption, institutional fraud, and transactional fraud, among

42. Stan Higgins, *The IRS Is Seeking Data on Coinbase’s Bitcoin Customers*, COINDESK (Nov. 18, 2016), <http://www.coindesk.com/irs-seeking-data-coinbases-bitcoin-customers/>.

43. Kelly Phillips Erb, *Congress Questions IRS on Efforts to Access Coinbase Customer Data*, FORBES (May 19, 2017), <https://www.forbes.com/sites/kellyphillipserb/2017/05/19/congress-questions-irs-on-efforts-to-access-coinbase-customer-data/#6dc46d992276>.

44. Stan Higgins, *Coinbase Prepares to Fight IRS Summons with New Court Filing*, COINDESK (Jan 13, 2017), <http://www.coindesk.com/coinbase-fight-irs-bitcoin-summons-filing/>.

45. Stan Higgins, *\$20,000: IRS to Exempt Casual Bitcoin Buyers from Coinbase Data Request*, COINDESK (July 10, 2017), <http://www.coindesk.com/20000-irs-exempt-casual-bitcoin-buyers-coinbase-data-request/>.

46. 26 U.S.C. § 6050W (2012) (governing returns relating to payments made in settlement of payment card and third-party network transactions).

47. To date, Coinbase has not responded. In November 2017, the District Court ordered Coinbase to produce “documents for accounts with at least the equivalent of \$20,000 in any one transaction type.” Order Re Petition to Enforce IRS Summons at 14, *United States v. Coinbase, Inc.*, No. 17-cv-01431-JSC, 2017 WL 5890052, at *8.

48. BD. OF GOVERNORS OF THE FED. RESERVE SYS., 2017 CURRENCY BUDGET 6, (2016), <https://www.federalreserve.gov/foia/files/2017currency.pdf>.

others.⁴⁹ Commentators note, “Bitcoin transactions are substantially cheaper and quicker than traditional payment networks.”⁵⁰ In comparing Bitcoin to traditional wire services, Bitcoin’s transaction fee is approximately 1/9 the cost of traditional wire-service companies such as Western Union and MoneyGram.⁵¹

2. Disadvantages of Cryptocurrencies

Despite the benefits of cryptocurrencies, there are several concerns with the current implementation of Bitcoin and how it may be used. Bitcoin has been used by criminals and those involved in the black market because of the pseudonymous structure of the blockchain.⁵² Cryptocurrencies could theoretically be used to launder money⁵³ in addition to selling and purchasing black market products.⁵⁴ Attempting to avoid association with money laundering, as well as the regulatory issues involved, “[S]everal bitcoin exchanges have taken steps to comply with anti-money laundering record-keeping and reporting requirements.”⁵⁵

There are also personal financial security issues with cryptocurrencies, although they may not be wholly different from traditional currency security issues.⁵⁶ Just like dropping a \$20 bill on the sidewalk without noticing, if a user’s digital “wallet,” which contains the private keys, is lost, the value associated with that wallet is also lost.⁵⁷

The infrastructure needed to facilitate use of cryptocurrencies can also be hacked, leading to stolen units.⁵⁸ The exchange called Bitfloor suffered a loss of 24,000 Bitcoins (valued at \$250,000) when hackers successfully

49. Hass McCook, *Under the Microscope: The Real Cost of a Dollar*, COINDESK (July 5, 2014), <http://www.coindesk.com/microscope-real-costs-dollar/>.

50. BRITO & CASTILLO, *supra* note 15, at 10.

51. *Id.* at 13.

52. *Id.* at 20.

53. *Id.* at 21.

54. Marco Santori, *Silk Road Goes Dark: Bitcoin Survives Its Biggest Market’s Demise*, COINDESK (May 5, 2017), <https://www.coindesk.com/bitcoin-milestones-silk-road-goes-dark-bitcoin-survives-its-biggest-markets-demise/>.

55. BRITO & CASTILLO, *supra* note 15, at 22.

56. *Id.* at 19.

57. *See id.*

58. *See* Rob Price, *One of the World’s Biggest Bitcoin Exchanges Has Been Hacked*, BUS. INSIDER (July 5, 2017), <http://www.businessinsider.com/south-korean-bitcoin-exchange-bithumb-hacked-ethereum-2017-7>.

hacked the system.⁵⁹ The Bitcoin exchange known as MtGox, which claimed to handle 80 percent of the global Bitcoin trade, filed for bankruptcy after 850,000 coins valued at \$480 million disappeared.⁶⁰ The former CEO of MtGox, Mark Karpeles, is currently facing embezzlement and data-manipulation charges in Japan.⁶¹

One unique aspect of cryptocurrency security breaches, as opposed to the theft of U.S. currency, is that when a bank is robbed or there is a digital theft of deposits, such activity does not impact the value of U.S. currency either held personally or in bank accounts.⁶² However, a security breach of Bitcoin does negatively affect the market value of Bitcoin, though such impact has not been permanent.⁶³

B. IRS Treatment of Cryptocurrencies

Given advances in technology over the last several decades, it is not unusual for various parts of the law to lag these advances. Amazon.com operated without collecting a sales tax in most states for over 20 years before states caught up with the status of e-commerce sales and began to enforce applicable sales taxes.⁶⁴ Today, Amazon.com collects a sales tax in all 45 states that assess it on end-user purchases.⁶⁵ Similar challenges face Bitcoin and other cryptocurrencies.

In early 2014, the National Taxpayer Advocate urged the IRS to issue guidelines on how Bitcoin should be treated for purposes of taxation.⁶⁶ At

59. BRITO & CASTILLO, *supra* note 15, at 19.

60. *Former MtGox CEO Heads to Trial in Japan over Missing Bitcoins*, SBS NEWS (July 9, 2017), <http://www.sbs.com.au/news/article/2017/07/09/former-mtgox-ceo-heads-trial-japan-over-missing-bitcoins>.

61. *Former MtGox Bitcoin Exchange Boss Pleads Not Guilty*, BBC NEWS (July 11, 2017), <http://www.bbc.com/news/technology-40561420>.

62. See BRITO & CASTILLO, *supra* note 15, at 4 (explaining that the value of bitcoin is not derived from other world currencies).

63. David Vorick, *Ensuring Bitcoin Fungibility in 2017 (And Beyond)*, COINDESK (Dec. 28, 2016), <https://www.coindesk.com/ensuring-bitcoin-fungibility-in-2017-and-beyond/>.

64. See Jeff Milchen, *To Help Mainstreet, Close the Sales Tax Loophole*, BLOOMBERG BUS. (Apr. 28, 2011), https://web.archive.org/web/20160315102652/http://www.businessweek.com/smallbiz/content/apr2011/sb20110428_074924.htm#p2.

65. Karla Bowsher, *Amazon to Charge Sales Tax in All but 5 States*, MONEYTALKS NEWS (Mar. 27, 2017), <https://www.moneytalksnews.com/the-45-states-where-amazon-will-charge-sales-tax-april/>.

66. Ryan Tracy, *Clarity Sought for Bitcoin Treatment*, WALL ST. J. (Jan. 9, 2014),

that point, Bitcoin had been in existence for five years, and the IRS had no guidance on how to treat transactions involving Bitcoin or other cryptocurrencies.⁶⁷ Again, this lag between technology and regulation is not uncommon. Like Amazon.com and sales tax, PayPal.com existed for 20 years before the IRS developed guidelines on how to report revenue received via PayPal.com and similar online payment processing services.⁶⁸

1. IRS Notice 2014-21

In April 2014, the IRS released Notice 2014-21, which described “how existing general tax principles apply to transactions using virtual currency.”⁶⁹ While some technology advances such as e-commerce and online payment processing services like PayPal required new legislation to deal with the tax implications, the IRS and Congress felt no need to develop new rules or laws for cryptocurrencies.⁷⁰ In 2011, when the IRS began to regulate PayPal and similar services,⁷¹ PayPal was conducting almost \$120 billion in net total payment volume.⁷² While a direct comparison is difficult because of the numerous cryptocurrencies functioning,⁷³ Bitcoin did not process such volume in 2014 when the IRS published its notice on the treatment of cryptocurrencies.⁷⁴ Today, cryptocurrencies will exceed that volume, with

<https://www.wsj.com/articles/clarity-sought-for-bitcoin-treatment-1389298672>.

67. See Tal Yellin et al., *What Is Bitcoin?*, CNN TECH, <http://money.cnn.com/infographic/technology/what-is-bitcoin/> (last visited Aug. 24, 2017).

68. Christina Mercer, *History of PayPal: The History of the Biggest Online Payment System in the World*, TECHWORLD (Nov. 25, 2015), <http://www.techworld.com/picture-gallery/business/history-of-paypal-1998-now-3630386/> (stating that PayPal has existed since 1998); see Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 3091(e)(1), 122 Stat. 2654, <https://www.gpo.gov/fdsys/pkg/PLAW-110publ289/pdf/PLAW-110publ289.pdf>.

69. I.R.S. Notice 2014-21, § 1 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html.

70. See *infra* notes 72–77.

71. While there were other services providers in the online payment processing industry, PayPal was by far the largest and most used system. See *10 Excellent Online Payment Systems*, WEBPAGEFX (May 15, 2012), <https://www.webpagefx.com/blog/web-design/online-payment-systems/>.

72. *eBay Inc. Reports Strong Fourth Quarter and Full Year 2011 Results*, EBAY (Jan. 18, 2012), http://files.shareholder.com/downloads/ebay/5097698907x0x534815/B8840A22-DDFA-43C0-9D29-9CF11EA0BEC0/EBAY_News_2012_1_18_Earnings.pdf.

73. *Bitcoin Stats*, BLOCKCHAIN, <https://blockchain.info/stats> (last visited Nov. 8, 2017) (providing a Bitcoin statistic summary every 24 hours).

74. See *Confirmed Transactions Per Day*, BLOCKCHAIN, <https://blockchain.info/>

transactions in excess of \$3 billion each day.⁷⁵

The IRS stated in Notice 2014-21 that virtual currencies such as Bitcoin will be treated as property for federal tax purposes.⁷⁶ While the IRS acknowledges that cryptocurrencies can operate “like ‘real’ currency” in some circumstances and can be used to sell or purchase goods and services, it noted that Bitcoin (at that time) did not have legal tender status in any U.S. jurisdiction.⁷⁷

2. *Using Cryptocurrencies in Transactions*

With the classification of cryptocurrencies as property, numerous resources must be reviewed to determine how to properly report transactions involving cryptocurrencies on tax returns and other income or transaction reporting forms. Those resources include IRS Notice 2014-21 and Publications 525, 544, and 551.⁷⁸

The purchase of a unit or partial unit of a cryptocurrency does not in itself lead to a reportable transaction. At the point of initial purchase, the transaction does not yet fall under the scope of “gross income” as defined under § 61 of the Internal Revenue Code.⁷⁹ However, receiving

charts/n-transactions?timespan=all (last visited Dec. 19, 2017) (providing the number of transactions per day from 2009 to today).

75. *See Cryptocurrency Market Capitalization*, COINMARKETCAP, <https://coinmarketcap.com/> (last visited Aug. 24, 2017).

76. I.R.S. Notice 2014-21, § 4, at A-1 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html.

77. *Id.* § 2.

78. *See id.* § 4; I.R.S. Pub. 544, at 5 (Feb. 9, 2017); I.R.S. Pub. 551, at 2 (Jan. 26, 2017); I.R.S. Pub. 525, at 4 (Jan. 23, 2017).

79. Gross income is defined in the IRC as:

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

- (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;

cryptocurrency in exchange for products or services, or exchanging cryptocurrency in a transaction involving the receipt of products or services, does fall under the definition of gross income.⁸⁰

Publication 525, Taxable and Non-Taxable Income, clarifies when a transaction that does not involve currency may still result in taxable income for at least one of the parties involved.⁸¹ “Bartering is an exchange of property or services.”⁸² Since cryptocurrency has been classified as property, transactions involving cryptocurrency would be considered a bartering arrangement.⁸³ When analyzing the impact of this cryptocurrency barter transaction, the perspectives of both the buyer and seller must be considered.

a. *Goods and services.* Ordinarily, when a consumer purchases a product or service, there is no need to look beyond exchanging money for the product or service received in the transaction. However, when cryptocurrency is involved, the transaction has an added stage for the consumer. As stated in Notice 2014-21, if the fair market value of the property received in a transaction exceeds the taxpayer’s adjusted basis of the cryptocurrency used in the exchange, there is a taxable gain that must be reported.⁸⁴ This would apply for every transaction in which a consumer engages where they are exchanging cryptocurrency for a product or service, unless there is an exception allowed under the Internal Revenue Code, such as a like-kind exchange or involuntary conversion.⁸⁵ The reporting of a gain or loss in an exchange will be discussed in subpart three below.⁸⁶

-
- (9) Annuities;
 - (10) Income from life insurance and endowment contracts;
 - (11) Pensions;
 - (12) Income from discharge of indebtedness;
 - (13) Distributive share of partnership gross income;
 - (14) Income in respect of a decedent; and
 - (15) Income from an interest in an estate or trust.

26 U.S.C. § 61(a) (2012).

80. *Id.*

81. *See* I.R.S. Pub. 525, at 19.

82. *Id.*

83. *See id.*

84. I.R.S. Notice 2014-21, § 3 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html.

85. *Id.* § 4.

86. *See* discussion *infra* Part II.B.3.

From the perspective of the seller, a barter transaction where the seller is receiving cryptocurrency in exchange for selling goods or services has minor differences from a traditional goods-or-services-for-money transaction. The seller still must recognize the sale of the good or service as revenue.⁸⁷ Unlike a sale for cash, however, the seller must determine the fair market value of the cryptocurrency received in the transaction. If the value of the goods or services was determined in advance of the barter transaction, that value can be used as the fair market value of the item sold.⁸⁸ IRS Notice 2014-21 further clarifies that the basis of the cryptocurrency received in a cryptocurrency barter transaction is the fair market value of the cryptocurrency as of the date of the receipt.⁸⁹ Logic would suggest that the two distinct values that Publication 525 and Notice 2014-21 refer to would be the same. However, it is possible that since cryptocurrency value fluctuates like publicly traded stocks, there may be minor deviations which, for the purposes of this Article, will not be clarified.⁹⁰

The seller who is receiving cryptocurrency in a barter transaction may choose to liquidate that cryptocurrency to U.S. currency immediately.⁹¹ This would eliminate or minimize the potential to report gain or loss on the exchange of the cryptocurrency in a future transaction. If, however, the seller holds the cryptocurrency received, there would be gain or loss implications on future barter transactions as previously discussed or on the eventual conversion to cash.⁹²

As a final note regarding the exchange of cryptocurrency for goods or services, if the purchaser in a cryptocurrency barter transaction is purchasing a capital asset, the buyer would need to calculate the basis of the property received in the transaction.⁹³

b. *Cryptocurrency as compensation.* The legal structure of the business does not change how and when revenue from a barter transaction is recognized. Throughout the text of IRS Notice 2014-21, the agency refers to “taxpayer” consistently, without indicating a distinction between an

87. 26 U.S.C. § 61 (2012).

88. See I.R.S. Pub. 525, at 19.

89. I.R.S. Notice 2014-21, §§ 3–4.

90. *Bitcoin (USD) Price*, COINDESK, <http://www.coindesk.com/price/> (last visited Aug. 24, 2017).

91. See I.R.S. Notice 2014-21, § 2.

92. *Id.* § 4.

93. I.R.S. Pub. 551, 2–3 (Jan. 26, 2017).

individual or an entity, including references to IRS documents that apply to individuals and businesses.⁹⁴

Cryptocurrency can be used as compensation for both employees and independent contractors, with minor differences from making payments in cash.⁹⁵ “[T]he fair market value of virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income and is subject to the self-employment tax.”⁹⁶

While an employee can be paid in cryptocurrency instead of U.S. currency, such a payment arrangement does not change the obligations of the employer to follow appropriate withholding requirements and information reporting.⁹⁷ Remuneration in the form of cryptocurrency is still considered wages for employment tax purposes.⁹⁸ Cryptocurrency compensation is subject to federal income tax and Federal Insurance Contributions Act (FICA) tax withholdings on behalf of the employee.⁹⁹ The employer is also still liable for FICA and Federal Unemployment Tax Act taxes.¹⁰⁰

Payments made to both employees and independent contractors are subject to information reporting.¹⁰¹ Compensation paid to an employee in the form of cryptocurrency would be included in the employee’s Form W-2, Wage and Tax Statement, which is issued to the employee and reported to the IRS.¹⁰² Likewise, an independent contractor would use Form 1099-MISC to report cryptocurrency-based payments.¹⁰³

3. *Gain or Loss upon Exchange and Character of Gain or Loss*

While cryptocurrency can be used to purchase products and services, as well as being a form of compensation, others see cryptocurrency as an investment or capital asset.

94. *See, e.g.*, I.R.S. Notice 2014-21, § 4 at A-4, A-6, A-9.

95. *Id.* at A-9, A-10.

96. *Id.* at A-10.

97. *Id.* at A-10, A-11.

98. *Id.* at A-11.

99. *Id.*

100. *Id.*

101. *Id.* at A-12.

102. *Id.* at A-11.

103. *Id.* at A-13.

The calculation of gain or loss upon the disposition of a unit of a cryptocurrency is no different from any other property or asset.¹⁰⁴

If the fair market value of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency, the taxpayer has taxable gain. The taxpayer has a loss if the fair market value of the property received is less than the adjusted basis of the virtual currency.¹⁰⁵

The character of the gain or loss that must be reported by the taxpayer will depend on the purpose of the asset for that individual taxpayer.¹⁰⁶ If Bitcoin is being held as a capital asset, the gain or loss upon disposition would be treated accordingly.¹⁰⁷ If Bitcoin is not being held as a capital asset, the taxpayer would recognize ordinary gain or loss on the disposition.¹⁰⁸ When a taxpayer has a transaction where cryptocurrency is exchanged for something—whether it is goods, services, or back into U.S. currency—that is a reportable transaction to the IRS for income tax purposes.¹⁰⁹

4. *Valuing Cryptocurrencies*

Regardless of how Bitcoin is used, if a transaction must be reported for tax purposes, it must be reported in U.S. dollars.¹¹⁰ Since our economy has moved beyond a barter economy, most transactions are easy to value. Even transactions involving publicly traded stock can easily be valued because the stock exchanges provide a way to readily calculate the value of the stock. Cryptocurrency transactions may not be so easy.¹¹¹

According to IRS Notice 2014-21, the value of cryptocurrency can be determined based on the value listed on a cryptocurrency exchange.¹¹² Using this method would establish the valuation of a cryptocurrency based on a market-supply-and-demand method.¹¹³ However, unlike the stock market where the stock of a publicly traded company is traded on only one

104. *Id.* at A-7.

105. *Id.* at A-6.

106. *Id.* at A-7.

107. *Id.*

108. *Id.*

109. I.R.S. Pub. 525, 4 (Jan. 23, 2017).

110. I.R.S. Notice 2014-21, § 4, at A-3.

111. *Id.*

112. *Id.* at A-5.

113. *Id.*

exchange, some cryptocurrencies can be traded on several exchanges, sometimes dozens of exchanges.¹¹⁴ Each Bitcoin exchange runs independent of other exchanges and values Bitcoin independent of the other exchanges.¹¹⁵ Valuation variances can be as much as 10 percent.¹¹⁶ Because of this variance, it is important to note that the IRS makes it clear that any such valuation conversions should be done in a reasonable and consistent manner.¹¹⁷

5. *Are Cryptocurrencies Fungible?*

Fungibility is the concept that one unit of a good or commodity can be exchanged for another unit of the good or commodity with little to no variance in the value of the units being exchanged.¹¹⁸ Goods and commodities such as oil, precious metals, and shares of stock are fungible.¹¹⁹ Currency is also fungible,¹²⁰ and that fungibility makes the operation of economies based on currency function in a quick and seamless fashion. Cryptocurrencies, however, are not as clear-cut, for there are two aspects of fungibility that may create issues.

First, as was discussed above, there are numerous cryptocurrencies, and each cryptocurrency may trade on several exchanges. Looking at Bitcoin, the value on each exchange varies slightly, though with the more popular exchanges, the value is quite comparable.¹²¹ As such, the value of one Bitcoin on one exchange is not necessarily the same as one Bitcoin on another exchange.¹²² Does this mean a Bitcoin on one exchange cannot be exchanged for a Bitcoin on another exchange? Not really. Transactions and exchanges can and do still take place, as is evidenced by the activity on the

114. *Cryptocurrency Exchanges/Markets List*, CRYPTOCHAINCHARTS, <https://www.cryptocoincharts.info/markets/info> (last visited Aug. 24, 2017).

115. *Currencies*, BITCOINCHARTS, <https://bitcoincharts.com/markets/currencies/> (last visited Aug. 24, 2017).

116. *See id.*

117. I.R.S. Notice 2014-21, § 4 at A-5.

118. *Fungibility*, FREE DICTIONARY, <http://financial-dictionary.thefreedictionary.com/fungible> (last visited Nov. 9, 2017).

119. *See Fungibility*, INVESTOPEDIA, <https://investopedia.com/terms/f/fungibility.asp> (last visited Nov. 9, 2017).

120. *See id.*

121. *Currencies*, *supra* note 115; *USD Exchange Trade Volume*, *supra* note 6.

122. *Currencies*, *supra* note 115.

exchanges.¹²³ One Bitcoin is typically seen as exchangeable for another Bitcoin.¹²⁴

The second potential issue of fungibility is directly related to Bitcoin's traceability. Unlike currency, each transaction of a cryptocurrency has a traceable path of where it has been digitally.¹²⁵ That traceability creates a distinction between transactions of the cryptocurrency with a clean history and those with a "dirty" (i.e., illegal or questionable) history.¹²⁶ Since cryptocurrencies are tracked by ledger accounts, one questionable transaction could have the potential of tarnishing all units held by that account at any point after the questionable transaction, and as a result the entire ledger balance would be "dirty," not just a specific unit.¹²⁷

Normal currency is traceable as well, but in a different sense. Serial numbers on currency can be used for law enforcement purposes, as well as for hobbyist tracking of where an individual bill has traveled in the country or world.¹²⁸ But the traceability of currency is limited in scope and often voluntary by the users. Cryptocurrency, however, can be traced through every transaction it has been involved with.¹²⁹ Merchants who accept cryptocurrency can evaluate proposed Bitcoin transfers and either reject ledger balance transfers of cryptocurrency that has a connection to questionable activity or certain vices, or be valued less because the "dirty" cryptocurrency they accepted may not be acceptable to other merchants.¹³⁰

III. REGULATORY TREATMENT OF CRYPTOCURRENCY

In considering whether the IRS has properly classified cryptocurrency as property, a review of how other government agencies have classified or approached cryptocurrency is relevant. Different federal regulatory bodies have taken different stances based on the scope of their individual authority and the mission of their organization.

123. See *USD Exchange Trade Volume*, *supra* note 6.

124. Vorick, *supra* note 63.

125. Shahla Hazratjee, Note, *Bitcoin: The Trade of Digital Signatures*, 41 T. MARSHALL L. REV 55, 66–67 (2015).

126. Vorick, *supra* note 63.

127. See *id.*

128. See *Welcome to Where's George*, WHERESGEORGE.COM, <https://www.wheresgeorge.com/> (last visited Sept. 2, 2017).

129. BRITO & CASTILLO, *supra* note 15, at 5.

130. See Vorick, *supra* note 63.

A. Federal Reserve Regulation

The Federal Reserve System, or “the Fed” as most refer to it, is the U.S. central bank, and among other things, it issues and distributes U.S. currency.¹³¹ Shortly after the largest Bitcoin exchange collapsed in 2014,¹³² the Chair of the Board of Governors of the Federal Reserve System, Janet Yellen, told the Senate Banking Committee:

Bitcoin is a payment innovation that’s taking place outside of the banking industry . . . [t]here’s no intersection at all, in any way, between Bitcoin and banks that the Federal Reserve has the ability to supervise and regulate. So the fed doesn’t have authority to supervise or regulate Bitcoin in anyway.¹³³

When pushed about the possibility of regulating or banning Bitcoin as several other countries had at that point, Yellen continued: “It’s not so easy to regulate Bitcoin because there’s no central issuer or network operator. This is a decentralized, global [entity].”¹³⁴ Yellen also stated, “But certainly it would be appropriate for Congress to ask questions about what the right legal structure would be for digital currencies . . .”¹³⁵ While Yellen’s comments directly referenced Bitcoin, her views should be applicable to all types of cryptocurrency.¹³⁶

B. FEC Regulation

The Federal Election Commission (FEC) is the federal agency tasked with enforcing federal campaign finance laws.¹³⁷ The FEC provides regulations and guidance to political campaigns on what may be accepted in the form of campaign contributions—both monetary and in-kind donations—as well as how those contributions should be reported and how

131. *About the Fed*, BD. GOVERNORS FED. RES., <https://www.federalreserve.gov/aboutthefed.htm> (last updated Aug. 21, 2017).

132. Paul Vigna, *5 Things About Mt. Gox’s Crisis*, WALL ST. J. (Feb. 25, 2014), <https://blogs.wsj.com/briefly/2014/02/25/5-things-about-mt-goxs-crisis/>.

133. Rob Wile, *YELLEN: Fed Has No Authority to Regulate Bitcoin*, BUS. INSIDER (Feb. 27, 2014), <http://www.businessinsider.com/yellen-on-bitcoin-2014-2>.

134. *Id.* (alteration in original).

135. *Id.*

136. *See id.*

137. *Mission and History*, FED. ELECTION COMMISSION, <https://www.fec.gov/about/mission-and-history/> (last visited Aug. 24, 2017).

they can be utilized or spent.¹³⁸ In 2014, the FEC was asked to consider whether a political action committee could accept Bitcoin, and, if so, how.¹³⁹

In contrast to the Fed's position, the FEC stated in the background summary of the advisory opinion that Bitcoin is a purely digital, "privately issued currency that was created in 2009."¹⁴⁰ In labeling Bitcoin a currency, the FEC acknowledged that Bitcoin recipients cannot immediately deposit such funds into a bank account within the required timeframe.¹⁴¹ However, the FEC went on to explain that the Federal Election Campaign Act defines a contribution as "[a] gift, subscription, loan . . . , advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office[]" and concluded that Bitcoin falls within the scope of what is considered a contribution.¹⁴²

So even though the FEC called Bitcoin "currency," it in fact does not treat Bitcoin as currency; it specifically related Bitcoin to an in-kind contribution in the form of stocks, bonds, and other items that will be liquidated by the campaign later.¹⁴³

C. Financial Crimes Enforcement Network Regulation

The U.S. Department of the Treasury has a division that handles financial crimes, the Financial Crimes Enforcement Network, or FinCEN. "The mission of the Financial Crimes Enforcement Network is to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities."¹⁴⁴

FinCEN issued its "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies" in March 2013.¹⁴⁵

138. *Id.*

139. Make Your Own Laws PAC, FEC Advisory Op. 2014-02, 1 (2014), <https://www.fec.gov/files/legal/aos/80054.pdf>.

140. *Id.* at 2.

141. *Id.* at 5–6.

142. 11 C.F.R. § 100.52(a) (2014); FEC Advisor Op. 2014-02, at 4.

143. FEC Advisor Op. 2014-02, at 4.

144. *Mission*, FINCEN, <https://www.fincen.gov/about/mission> (last visited Aug. 24, 2017).

145. DEP'T OF THE TREASURY: FIN. CRIMES ENF'T NETWORK, FIN-2013-G001, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING,

FinCEN stated that “‘virtual currency’ is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency,” specifically noting that virtual currencies like Bitcoin are not accepted as legal tender in any jurisdiction.¹⁴⁶ FinCEN concluded that virtual currency has an equivalent value in real currency or can act as a substitute for real money.¹⁴⁷ FinCEN determined that “virtual currencies are subject to regulation if that virtual currency has a substitutive purpose for facilitating exchanging goods and services.”¹⁴⁸

Later in 2013, FinCEN interpreted its statutory authority to extend to exchangers and administrators of virtual currencies so that they fall under its regulatory scope while excluding users of Bitcoin and other virtual currencies.¹⁴⁹ In 2014, FinCEN issued further guidance, in the form of two administrative rulings, on applying its regulations to exchangers and administrators of virtual currencies.¹⁵⁰ FinCEN was asked two questions regarding virtual currencies in general, not Bitcoin specifically, but the answers are relevant to Bitcoin as well as other cryptocurrencies.¹⁵¹ FinCEN’s 2014 administrative rulings focused on whether a company dealing in virtual currencies would be considered a money-services

EXCHANGING, OR USING VIRTUAL CURRENCIES 1 (2013), <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf> [hereinafter FIN-2013-G001].

146. *Id.* at 1. At the time that FinCEN issued its guidance, cryptocurrencies were not recognized as legal tender in any U.S. jurisdiction; this has not changed as of Sept. 2, 2017.

147. *Id.*

148. Ralph E. McKinney, Jr. et al., *The Evolution of Financial Instruments and the Legal Protection Against Counterfeiting: A Look at Coin, Paper, and Virtual Currencies*, 2015 U. ILL. J.L. TECH. & POL’Y 273, 275 (2015).

149. FIN-2013-G001, *supra* note 145, at 3–5.

150. *See* DEP’T OF THE TREASURY: FIN. CRIMES ENF’T NETWORK, FIN-2014-R011, REQUEST FOR ADMINISTRATIVE RULING ON THE APPLICATION OF FINCEN’S REGULATIONS TO A VIRTUAL CURRENCY TRADING PLATFORM 6 (2014), https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R011.pdf [hereinafter FIN-2014-R011] (ruling that a virtual currency trading-and-booking platform would qualify the requester as a money transmitter under the Bank Secrecy Act); *see also* DEP’T OF THE TREASURY: FIN. CRIMES ENF’T NETWORK, FIN-2014-R012, REQUEST FOR ADMINISTRATIVE RULING ON THE APPLICATION OF FINCEN’S REGULATIONS TO A VIRTUAL CURRENCY PAYMENT SYSTEM 3 (2014), https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R012.pdf [hereinafter FIN-2014-R012] (ruling that a virtual currency payment system would qualify the requester as a money transmitter under the Bank Secrecy Act).

151. *See* FIN-2014-R011, *supra* note 150, at 5; *see also* FIN-2014-R012, *supra* note 150, at 5.

business.¹⁵²

Under the Bank Secrecy Act (BSA), FinCEN has the authority to regulate money-services businesses.¹⁵³

The term “money services business” includes any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities: (1) Currency dealer or exchanger[;] (2) Check casher[;] (3) Issuer of traveler’s checks, money orders or stored value[;] (4) Seller or redeemer of traveler’s checks, money orders or stored value[;] (5) Money transmitter[; or] (6) U.S. Postal Service.¹⁵⁴

In the first administrative ruling, FIN-2014-R011, FinCEN was asked if setting up a “virtual currency trading and booking platform . . . would make the [c]ompany a money transmitter under the BSA.”¹⁵⁵ The proposed virtual trading-and-booking platform would be exchanging virtual currency for U.S. currency, or a “convertible virtual currency for currency of legal tender (‘real currency’)” and vice versa.¹⁵⁶ Specifically, FinCEN was asked if a convertible virtual currency trading platform would require the company to be considered a money-services business.¹⁵⁷ In other words, the question is whether a company that is facilitating cryptocurrency transactions between users would be considered a “money transmitter” when the trade does not actually involve money.¹⁵⁸

FinCEN defines money transmitter to “include a person that provides money transmission services.”¹⁵⁹ Money-transmission services include the “acceptance of currency, funds, or other value that substitutes for currency from one person *and* the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.”¹⁶⁰ In this administrative ruling, FinCEN determined that under the proposed

152. See FIN-2014-R011, *supra* note 150, at 1; FIN-2014-R012, *supra* note 150, at 1.

153. 31 C.F.R. § 1022.380(a)–(f) (2016).

154. *Money Services Business Definition*, FINCEN, <https://www.fincen.gov/money-services-business-definition> (last visited Dec. 21, 2017); see also 31 C.F.R. § 1010.100(ff) (2014) (providing the regulatory definition).

155. FIN-2014-R011, *supra* note 150, at 1.

156. *Id.*

157. *Id.*; FIN-2014-R012, *supra* note 150, at 5.

158. FIN-2014-R011, *supra* note 150, at 2–3.

159. *Id.*

160. *Id.*

structure, the company would be a money-services business, disagreeing with the characterization that the money transmission would occur directly between the two users (or customers, as referenced by the company).¹⁶¹ “The [c]ompany is facilitating the transfer of value, both real and virtual, between third parties” and does not qualify for an exemption.¹⁶²

The second administrative ruling, FIN-2014-R-012, had a similar but slightly nuanced query.¹⁶³ Instead of a virtual currency trading-and-booking platform,¹⁶⁴ the company was planning to set up a convertible virtual currency payment system.¹⁶⁵ The proposed payment system would allow consumers using currency to purchase products or services from vendors who wished to be paid in Bitcoin.¹⁶⁶ The ruling focused on whether such a virtual currency payment system would prompt FinCEN to consider the company to be a money transmitter and subject to the rules of a money services business.¹⁶⁷

FinCEN determined that this slightly nuanced structure still fell within the definition of money transmitter and thus a money-services business, stating:

An exchanger will be subject to the same obligations under FinCEN regulations regardless of whether the exchanger acts as a broker (attempting to match two (mostly) simultaneous and offsetting transactions involving the acceptance of one type of currency and the transmission of another) or as a dealer (transacting from its own reserve in either convertible virtual currency or real currency).¹⁶⁸

FinCEN did clarify that while the payment system proposed was intended to accommodate Bitcoin transactions, the ruling would also apply

161. *Id.* at 3.

162. *Id.* at 4.

163. FIN-2014-R012, *supra* note 150, at 1.

164. Think of a company that provides stock trade services, such as Merrill Lynch or eTrade, and assists consumers with buying and selling stock of publicly traded companies and other commodities.

165. *Id.* at 1. Think of a company like Visa, Mastercard, or PayPal that facilitates transferring money from one person to another in order to accommodate a consumer transaction.

166. *Id.*

167. *Id.*

168. *Id.* at 3.

to payments in other virtual currencies.¹⁶⁹

IV. COURT TREATMENT OF CRYPTOCURRENCY

With limited and mixed guidance from the regulatory state, courts have been left to their own devices to consider issues involving cryptocurrency. Federal court cases that mention cryptocurrency are at the district court level.¹⁷⁰ None of these cases deal with the legal nature of cryptocurrency as the subject of the case. Instead, cryptocurrency has been brought in as a tangential matter with the character of cryptocurrency sometimes having little impact on the outcome of the case.

There are challenges in reviewing the judicial treatment of cryptocurrency, including no appellate review of substantive cases and few cases that specifically deal with the definition and structure of cryptocurrency. A discussion of these cases follows.

A. SEC v. Shavers

The first apparent judicial foray concerning Bitcoin was seen in 2013 when the Securities and Exchange Commission (SEC) pursued a Texas-based Ponzi scheme in *SEC v. Shavers*.¹⁷¹ The SEC asserted “that Shavers made a number of misrepresentations to investors regarding the nature of the investments and that he defrauded investors”¹⁷² when he promised a return of 1 percent per day on investments in a company called Bitcoin Savings and Trust (BTCST).¹⁷³ Shavers did not accept cash in exchange for investments in BTCST; investments were only accepted in the form of Bitcoin.¹⁷⁴ Because of this, Shavers argued that the court did not have subject matter jurisdiction because the investments in BTCST were not securities as

169. *Id.* at 5.

170. *See, e.g.*, *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at *6 (W.D.N.Y. Dec. 1, 2016) (recommending that a charge against the defendant be dropped because Bitcoin is not a currency); *United States v. 50.44 Bitcoins*, No. ELH-15-3692, 2016 WL 3049166, at *2 (D. Md. May 31, 2016) (ruling the Bitcoin can be subject to forfeiture actions by the government); *SEC v. Shavers*, No. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex. Aug. 6, 2013) (ruling that there was subject matter jurisdiction over the case where Bitcoin was the substance of the investment).

171. *Shavers*, 2013 WL 4028182, at * 1.

172. *Id.* at *1.

173. *Id.*

174. *Id.* at *2.

defined by federal securities laws.¹⁷⁵

In a memorandum opinion, the court determined that the investments in BTCST are investments under the definition of an investment contract and, therefore, are securities.¹⁷⁶ But beyond the subject matter before the court, the ruling is important for what it declares about Bitcoin:

. . . Bitcoin can be used as money. It can be used to purchase goods or services, and as Shavers stated, used to pay for individual living expenses. The only limitation of Bitcoin is that it is limited to those places that accept it as currency. However, it can also be exchanged for conventional currencies, such as the U.S. dollar, Euro, Yen, and Yuan. Therefore, *Bitcoin is a currency* or form of money, and investors wishing to invest in BTCST provided an investment of money.¹⁷⁷

Even though the issue of the case was based in securities laws, Bitcoin was a central component of the case as it was the foundation of the investment.¹⁷⁸ The court's determination that Bitcoin was a currency is a groundbreaking ruling for cryptocurrencies.¹⁷⁹ Although the ultimate resolution of *Shavers* did not happen until September 2014, the memorandum opinion issued by the U.S. District Court for the Eastern District of Texas declaring Bitcoin a currency was issued in August 2013,¹⁸⁰ prior to the IRS's issuance of Notice 2014-21.¹⁸¹

B. United States v. Petix

To show that the treatment of Bitcoin is a very unsettled area of the law, a magistrate judge in the U.S. District Court for the Western Division of New York came to the opposite conclusion of *Shavers* in a Report and Recommendation in December 2016.¹⁸² In *United States v. Petix*, the

175. *Id.* at *1.

176. *Id.*

177. *Id.* at *2 (emphasis added).

178. *Id.*

179. *Id.*

180. *See id.*

181. I.R.S. Notice 2014-21 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html.

182. *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at *7 (W.D.N.Y. Dec. 1, 2016). It is important to note that this ruling is a Report and Recommendation from a magistrate judge to the Honorable Richard J. Arcara of the U.S. District Court for the Western District of New York. To date, a published ruling has not been issued indicating the follow-up of this case.

defendant was charged with running an unlicensed money-transmitting business in violation of 18 U.S.C. § 1960 when the defendant was engaged in Bitcoin transactions.¹⁸³ This is the same section of the U.S. Code at issue in *Shavers*.

In *Petix*, the court urged caution in applying ordinary dictionary terms that may be used in a different way by people in everyday life.¹⁸⁴ Although used in § 1960, the terms “money” and “funds” are not actually defined in the section, and thus the court went on an extensive journey to define what they mean in reference to its application.¹⁸⁵

“‘Money,’ in its common use, is some kind of financial instrument or medium of exchange that is assessed value, made uniform, regulated, and protected *by sovereign power*. . . . Ordinary people in everyday life know this intuitively; the average person who hears the term ‘money’ will think of government-issued ‘dollars’ or instruments”¹⁸⁶ The court continued to note that individual states cannot coin money or influence the value of money.¹⁸⁷

The court concluded, “Bitcoin is not ‘money’ as people ordinarily understand that term. Bitcoin operates as a medium of exchange like cash but does not issue from or enjoy the protection of any sovereign”¹⁸⁸ The court continued by stating that “the whole point of Bitcoin is to escape any entanglement with sovereign governments. Bitcoins themselves are simply computer files generated through a ledger system that operates on block chain [sic] technology.”¹⁸⁹

Despite the disparate rulings in *Shavers* and *Petix*, the cases do have parallels, including similar underlying criminal acts—both defendants were accused of defrauding investors, although they were charged under different sections of the U.S. Code. But beyond that, the *Shavers* court was determining if the defendant was engaged in securities fraud, where subsequently the court ruled that not only was Bitcoin a form of currency as the court considered Bitcoin contracts as a security,¹⁹⁰ it was sufficiently used

183. *Id.* at *1.

184. *Id.* at *3.

185. *Id.* at *4.

186. *Id.*

187. *Id.* at *5 (citing *Laycock v. Kenney*, 270 F.2d 580, 590 (9th Cir. 1959)).

188. *Id.*

189. *Id.*

190. *SEC v. Shavers*, No. 4:13-CV-416, 2013 WL 4028182, at *8 (E.D. Tex. Aug. 6,

in a Ponzi scheme by the defendant.¹⁹¹ On the other hand, the *Petix* court found that Bitcoin is not included in the definition of “money” and “funds” under 18 U.S.C. § 1960, agreeing with the defendant in his effort to have a charge dismissed against him, and thus this court stepped closer to the heart of the issue of whether Bitcoin is currency.¹⁹²

C. Bitcoin in Forfeiture Actions

The U.S. Government has pursued the forfeiture of Bitcoin in civil forfeiture cases, including in *United States v. 50.44 Bitcoins*.¹⁹³ The federal government acted to seize 50.44 Bitcoins that were believed to be connected to illegal activity on the Silk Road.¹⁹⁴ The Bitcoins were titled as the defendants in the action, as no individual ever stepped forward to claim ownership or control over them, perhaps because of their purported connection to illegal behavior.¹⁹⁵

In analyzing the government’s motion for default judgment, the court walked through the legal steps related to forfeiture actions, including what property is subject to forfeiture.¹⁹⁶ “Under 18 U.S.C. § 981, ‘any property, real or personal, involved in a transaction or attempted transaction in violation of [18 U.S.C. §1960], or any property traceable to such property’ is ‘subject to forfeiture to the United States.’”¹⁹⁷ As such, the *50.44 Bitcoins* court did not go beyond the required analysis, applying the standard language of 18 U.S.C. § 981 to conclude Bitcoin was property involved in a transaction that violated regulations regarding money transmission.¹⁹⁸

Likewise, in a criminal forfeiture action, the U.S. District Court for the

2013).

191. *Id.*

192. *Petix*, 2016 WL 7017919, at *5.

193. *United States v. 50.44 Bitcoins*, No. ELH-15-3692, 2016 WL 3049166, at *1 (D. Md. May 31, 2016).

194. *Id.* at *2. The Silk Road was the black market of the cyber-underworld and was dismantled by the federal government in 2014. See Donna Leinwand Leger, *How FBI Brought Down Cyber-Underworld Site Silk Road*, USA TODAY (Oct. 21, 2013), <https://www.usatoday.com/story/news/nation/2013/10/21/fbi-cracks-silk-road/2984921/>.

195. Due to the anonymous nature of Bitcoin, law enforcement speculated on who the owner of the Bitcoins was, but the person was never personally named in the forfeiture action. *50.44 Bitcoins*, 2016 WL 3049166, at *3.

196. *Id.* at *1.

197. *Id.* (alteration in original).

198. *Id.* at *2.

District of Nevada applied similar statutes to arrive at the same conclusion. In *United States v. Holden*, the defendant pleaded guilty to one count of “Accessing Protected Computer to Defraud” and agreed to forfeiture of property, including an unstated number of Bitcoin.¹⁹⁹ In determining which property was subject to forfeiture, the court in *Holden* used a different subsection of 18 U.S.C. § 981, which states “any property, real or personal, constituting or derived from, any proceeds obtained, directly or indirectly, as a result of a violation of Title 18, United States Code, Section 1030(a)(4).”²⁰⁰ With no further analysis other than stating that “any and all funds contained in the Bitcoin and Dogecoin wallets or accounts . . . constitute[] property,” the court authorized the forfeiture of Bitcoin as property.²⁰¹

While *50.44 Bitcoins* and *Holden* may lead some to infer that federal courts may be moving toward classifying Bitcoin as property, further review of the treatment of property under 18 U.S.C. § 981 does not support that.²⁰² It is not unusual for courts to reference accounts as property, even though the account is holding money.²⁰³ For example, in *United States v. \$688,670.42 Seized from Regions Bank Account No. XXXXXX5028*, the property at issue was a bank account containing almost \$700,000.²⁰⁴ The basis of the action was whether the bank account contained proceeds traceable to a violation of § 981 such that it was subject to civil forfeiture.²⁰⁵ There was no discussion of whether the money represented in the referenced bank account was considered property or currency.²⁰⁶ The currency represented by the account’s balance was considered property.

V. INTERNATIONAL, STATE, AND INDUSTRY TREATMENT OF BITCOIN

Under Article I of the U.S. Constitution, Congress has the sole power to coin money.²⁰⁷ Consequently, individual states and municipalities do not

199. *United States v. Holden*, 2:17-cr-00015-RFB (D. Nev. Mar. 23, 2017), <https://www.leagle.com/decision/infdco20170404c93>.

200. *Id.*

201. *Id.*

202. *See Holden*, No. 2:17-Cr-00015; *50.44 Bitcoins*, 2016 WL 3049166, at *2.

203. *See United States v. \$688,670.42 Seized from Regions Bank Account No. XXXXXX5028*, No. 11-10886, slip op. at 1 (11th Cir. Dec. 23, 2011).

204. *Id.* at 2.

205. *Id.*

206. *Id.* at 3.

207. U.S. CONST. art. I, § 8.

have the power to coin money or otherwise declare a currency.²⁰⁸ However, some states have taken steps to define cryptocurrencies for purposes of law enforcement and economic matters. It may also be helpful to consider how other countries have treated cryptocurrency. The Library of Congress has compiled data regarding the regulation of Bitcoin throughout the world.²⁰⁹

A. Individual State Treatment

Only two states have implemented regulation of Bitcoin: Florida and New York.²¹⁰ In response to a ruling where a judge threw out a money laundering charge because the judge determined Bitcoin should not be considered real money,²¹¹ The Florida State Legislature passed House Bill 1379, which designates virtual currency as a monetary instrument.²¹² Florida Governor Rick Scott signed the legislation June 23, 2017.²¹³

The New York State Department of Financial Services (NYDFS) has probably the most complete set of virtual currency regulation for a state within its Title 23, titled “Virtual Currencies,”²¹⁴ a 44-page volume of how NYDFS categorizes Bitcoin and how it requires anyone engaging in a “Virtual Currency Business Activity” to obtain a license.²¹⁵ The New York regulation is currently being challenged in court as being beyond the scope

208. See U.S. CONST. amend. X.

209. *Regulation of Bitcoin in Selected Jurisdictions*, L. LIBR. CONGRESS (Jan. 2014), <http://www.loc.gov/law/help/bitcoin-survey/index.php>. The Library of Congress does not make a distinction between Bitcoin and other cryptocurrencies, using Bitcoin as both a noun and proper noun. For purposes of this Article, the assumption is that Bitcoin is being used as a substitute for cryptocurrency, and thus international regulation is based on all potential cryptocurrencies and not simply Bitcoin.

210. N.Y. COMP. CODES R. & REGS. Tit. 23, §§ 200.1–200.2 (2018) (introducing a regulatory scheme to regulate virtual currency and defining virtual currency); David Ovalle, *Bitcoin Not Money, Miami Judge Rules in Dismissing Laundering Charges*, MIAMI HERALD (July 25, 2016), <http://www.miamiherald.com/news/local/crime/article91682102.html> (quoting Order Granting Defendant’s Motion to Dismiss the Information at 7, *State v. Espinoza*, No. F14-2923 (Fla. Cir. Ct. July 22, 2016), [http://www.miamiherald.com/latest-news/article91701087.ece/BINARY/Read%20the%20ruling%20\(.PDF\)](http://www.miamiherald.com/latest-news/article91701087.ece/BINARY/Read%20the%20ruling%20(.PDF))).

211. Ovalle, *supra* note 210 (quoting *Espinoza*, No. F14-2923 at 7).

212. H.B. 1379, 2017 Leg., at 8 (Fla. 2017).

213. *Gov. Scott Signs 38 Bills into Law*, NBC-2 (June 23, 2017), <http://www.nbc-2.com/story/35738531/gov-scott-signs-38-bills-into-law>; see H.B. 1379 at § 11.

214. N.Y. COMP. CODES R. & REGS. Tit. 23, §§ 200.1 (2018).

215. *Id.* § 200.3.

of statutory authority of the NYDFS.²¹⁶

Several other states are considering legislation.²¹⁷ Hawai'i is considering legislation that would explore the use of blockchain technology to help boost its tourism and technology.²¹⁸ The bill was passed by the Hawai'i House of Representatives and was forwarded to the Hawai'i Senate Committee on Ways and Means.²¹⁹ Washington State is considering legislation that would provide protection for consumers.²²⁰ Working off a foundation of definitions, the bill would require surety bonds for online exchanges, as well as disclosure requirements to consumers.²²¹ Looking to support financial innovation, Illinois has published proposed guidance on cryptocurrencies and on how the Illinois Transmitters of Money Act would apply.²²²

B. *International Views of Cryptocurrencies*

Almost a dozen countries have stated that Bitcoin and other cryptocurrencies are not considered to be money or currency and are not acceptable as legal tender.²²³ This includes Australia, China, Germany, and Ireland.²²⁴ Additionally, Taiwan went so far as to state that "bitcoin is not a real currency, but a 'highly speculative virtual commodity.'"²²⁵ Despite these declarations that it is not recognized as money, Bitcoin is still a prevalent device in transactions for goods and services or for investment purposes in countries such as Turkey.²²⁶

216. Jim Harper, *New York's "BitLicense" on Trial*, COMPETITIVE ENTERPRISE INST. (Mar. 8, 2017), <https://cei.org/blog/new-yorks-bitlicense-trial>.

217. See Michael Scott, *How Five States Are Approaching Bitcoin Regulation*, BITCOIN MAG. (May 15, 2017), <https://bitcoinmagazine.com/articles/how-five-states-are-approaching-bitcoin-regulation> (stating that California, Hawai'i, Illinois, and Washington are all attempting to regulate Bitcoin).

218. Anna Hrushka, *Bill Proposing Blockchain Technology Working Group Crosses Over to Senate*, PAC. BUS. NEWS (Mar. 9, 2017), <https://www.bizjournals.com/pacific/news/2017/03/09/bill-proposing-blockchain-technology-working-group.html>.

219. *Id.*

220. Scott, *supra* note 217.

221. *Id.*

222. *Id.*

223. See *Regulation of Bitcoin in Selected Jurisdictions*, LIBR. CONGRESS (Nov. 7, 2016), <https://www.loc.gov/law/help/bitcoin-survey/>.

224. *Id.*

225. *Id.*

226. *Id.*

In comparison, Canada regulates Bitcoin similarly to the United States.²²⁷ The Governor General of Canada approved bill C-31, which regulates Bitcoin as a money-services business, as FinCEN has labeled Bitcoin exchanges.²²⁸ This has not changed Canada's position that Bitcoin is not a currency and is not recognized as legal tender.²²⁹

While Brazil has acknowledged the potential for regulation of Bitcoin via mobile payment systems and electronic currencies, other countries have gone so far as to accept Bitcoin as an alternative payment method.²³⁰ In early 2014, the Estonian Tax Authority recognized Bitcoin as an alternative payment method and defined how Bitcoin transactions should be taxed—as capital gains.²³¹ Estonia is also taking steps to establish its own cryptocurrency, Estcoin.²³² Alternatively, New Zealand has taken a more hands-off approach, with the Reserve Bank of New Zealand stating:

The Reserve Bank of New Zealand Act prohibits the issuance of bank notes and coins by any party other than the Reserve Bank. However, the Reserve Bank has no direct power over any form of alternative payments medium.

Non-banks do not need our approval for schemes that involve the storage and/or transfer of value (such as 'bitcoin')—so long as they do not involve the issuance of physical circulating currency (notes and coins).²³³

The governments of numerous countries have gone so far as to issue warnings to consumers and businesses about Bitcoin. The European Banking Authority (EBA) issued a warning in 2013 about the dangers of

227. *See id.*

228. *Id.*

229. *Id.* (citing David George-Cosh, *Canada Says Bitcoin Isn't Legal Tender*, WALL ST. J. (Jan. 16, 2014), <http://blogs.wsj.com/canadarealtime/2014/01/16/canada-says-bitcoin-isnt-legal-tender/>).

230. *Id.*

231. *Id.*

232. Ryan Browne, *Estonia Wants to Launch Its Own Government-Backed Cryptocurrency Called "Estcoin"*, CNBC (Aug. 23, 2017) <https://www.cnbc.com/2017/08/23/estonia-cryptocurrency-called-estcoin.html>.

233. *Id.* (quoting *Notes and Coins Frequently Asked Questions*, RES. BANK N.Z., <https://web.archive.org/web/20170407100251/http://www.rbnz.govt.nz/faqs/notes-and-coins-faqs> (last visited Jan. 17, 2018)).

virtual currencies and transactions involving virtual currencies.²³⁴ Shortly after the EBA statement, France, a member of the European Union, released a report warning of the dangers of virtual currencies.²³⁵ Singapore is another country that has warned of the dangers of dealing with virtual currencies and the suspected connections to money laundering and other illegal activities.²³⁶

Numerous countries have taken a position on the taxation of transactions involving Bitcoin, including Finland, Australia, Estonia, and Norway.²³⁷ Both Norway and Finland base their theories of taxation on how the Bitcoin is used.²³⁸ Capital property is taxed as a capital gain, while the sale of goods and services is treated as ordinary income and subject to relevant taxes, including value-added tax.²³⁹

Two countries have taken steps to recognize Bitcoin as a currency. The Swedish Tax Board has issued a preliminary ruling that Bitcoin is regulated and treated as a currency in Sweden and that the value-added tax is not applicable to Bitcoin trade.²⁴⁰ In Japan, Bitcoin and other virtual currencies

234. EUROPEAN BANKING AUTH., WARNING TO CONSUMERS ON VIRTUAL CURRENCIES 2–3 (2013), <https://www.eba.europa.eu/documents/10180/598344/EBA+Warning+on+Virtual+Currencies.pdf>; see also *Regulation of Bitcoin in Selected Jurisdictions*, *supra* note 223 (citing EUROPEAN BANKING AUTH., *supra*).

235. *Regulation of Bitcoin in Selected Jurisdictions*, *supra* note 223 (citing BANQUE DE FRANCE, THE DANGERS LINKED TO THE EMERGENCE OF VIRTUAL CURRENCIES: THE EXAMPLE OF BITCOINS 3 (2013), <https://bravenewcoin.com/assets/Industry-Reports-2013/Banque-De-France-Focus10-the-dangers-linked-to-the-emergence-of-virtual-currencies-the-example-of-bitcoins-GB.pdf>).

236. *Id.*; *Consumer Advisory on Investment Schemes Involving Digital Tokens (Including Virtual Currencies)*, MONETARY AUTHORITY SING. (Oct. 8, 2017), <http://www.mas.gov.sg/News-and-Publications/Media-Releases/2017/Consumer-Advisory-on-Investment-Schemes-Involving-Digital-Tokens.aspx>.

237. *Regulation of Bitcoin in Selected Jurisdictions*, *supra* note 223.

238. *Id.* (Norway (citing *Bruk av bitcoins – skatte- og avgiftsmessige konsekvenser* [Use of Bitcoins – Tax Issues], SKATTEETATEN (Nov. 11, 2013), <http://www.skatteetaten.no/no/Radgiver/Rettskilder/Uttalelser/Prinsipputtalelser/Bruk-av-bitcoins—skatte—og-avgiftsmessige-konsekvenser/>); Finland (citing *Inkomstbeskattning av Virtuella Valutor* [Income Taxation of Virtual Currencies], VERO SKATT (Aug. 28, 2013) http://www.vero.fi/sv-FI/Detailerade_skatteanvisningar/Inkomstbeskattning_av_personkunder/Inkomstbeskattning_av_virtuella_valutor%2828454%29)).

239. *Id.*

240. *Id.* (demonstrating that the decision to not apply value-added tax to cryptocurrencies has been appealed by the Swedish Tax Authority) (citing *Mervardesskat: Handel med Bitcoins* [VAT: Trade with Bitcoins], SKATTERATTSNAMNDEN, (Oct. 14, 2013), <http://skatterattsnamnden.se/skatteerat>

have legislatively been declared legal currencies.²⁴¹

C. Accounting Industry Reactions to Cryptocurrencies

While some countries weigh the legality of Bitcoin, others are considering how Bitcoin and cryptocurrencies should be accounted. When Japan's legislature passed legislation to make Bitcoin legal currency, the Accounting Standards Board of Japan also agreed to "create a framework to determine how the accounting sector can address digital currency."²⁴²

The Australian Accounting Standards Board published *Digital Currency—A Case for Standard Setting Activity* in late 2016, noting that the International Financial Reporting Standards by the International Accounting Standards Board lacked clarity and guidance on cryptocurrencies.²⁴³

Most recently, the U.S. Financial Accounting Standards Board (FASB) has indicated that they are "considering whether it needs to develop accounting guidance for digital currencies."²⁴⁴ The Chamber of Digital Commerce encouraged FASB to develop accounting standards, writing: "As there is a lack of clear guidance for these digital currencies, there is currently a diversity of views on the accounting"²⁴⁵

VI. CONFLICTING LEGAL AND REGULATORY INTERPRETATIONS OF CRYPTOCURRENCIES

The U.S. economy is based on currency, using the dollar as its denomination. Until 2009 and the introduction of Bitcoin as a cryptocurrency, the economy functioned relatively seamlessly using

tsnamnden/forhandsbesked/2013/forhandsbesked2013/mervardesskatthandelmedbitcoins.5.46ae6b26141980f1e2d29d9.html).

241. Lester Coleman, *Japan Accepts Bitcoin as Legal Payment Method. What's Next?*, CCN (Apr. 5, 2017), <https://www.cryptocoinsnews.com/japan-accepts-bitcoin-as-legal-payment-method-whats-next/>.

242. *Id.*

243. Samjurab Das, *Bitcoin a 'Material Enough Phenomenon' for Accounting Standards, Says Australian Govt*, CCN (Nov. 22, 2016) <https://www.cryptocoinsnews.com/bitcoin-material-enough-phenomenon-accounting-standards-says-australian-govt/>.

244. *Bitcoin Seeks Recognition From U.S. GAAP*, THOMSON REUTERS TAX & ACCT. (July 11, 2017), <https://tax.thomsonreuters.com/media-resources/news-media-resources/checkpoint-news/daily-newsstand/bitcoin-seeks-recognition-from-u-s-gaap/>.

245. *Id.*

currency,²⁴⁶ although bartering was still employed to a limited extent.²⁴⁷ Cryptocurrencies have created a new approach to paying for goods and services, an approach that many are embracing, considering the volume of trades and level of market capitalization.²⁴⁸ The wide array of governmental agencies that collectively create and enforce the laws and regulations guiding individual lives are applying respective subjective logic to cryptocurrencies to determine how they should be treated for that agency's specific purposes.²⁴⁹ This is creating contradictory views and applications of cryptocurrency. This lack of a collective approach to cryptocurrencies is putting users, exchanges, and merchants at a disadvantage and perhaps hindering the development and growth of cryptocurrencies.²⁵⁰ The IRS has added to this confusion by classifying cryptocurrencies as property.²⁵¹

A. Treated as Currency

Numerous governmental agencies and courts have pointed out the similarities between cryptocurrencies and the U.S. dollar.²⁵² Courts have used a variety of terms to refer to cryptocurrency and Bitcoin, including “digital payment system,”²⁵³ “online digital banking service[,]”²⁵⁴ “digital asset and an innovative payment system released as open-source software[,]”²⁵⁵ and something that “operates as a medium of exchange like cash.”²⁵⁶

246. See FIN-2013-G001, *supra* note 145.

247. See *supra* Part II.B.

248. See Jamie Redman, *Markets Update: Cryptocurrency Market Cap Now Commands \$200 Billion*, BITCOIN.COM (Nov. 3, 2017), <https://news.bitcoin.com/markets-update-cryptocurrency-market-cap-200-billion/>.

249. See *supra* Part III.

250. See *supra* Part III.

251. I.R.S. Notice 2014-21, § 4, at A-1 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html.

252. See, e.g., *id.* § 2 (“In some environments, it operates like ‘real’ currency . . .”); *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at *6 (W.D.N.Y. Dec. 1, 2016); *SEC v. Shavers*, NO. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex. Aug. 6, 2013) (“Bitcoin can be used as money. It can be used to purchase goods or services . . .”).

253. *Green v. Mizuho Bank Ltd.*, 169 F. Supp. 3d 855, 858 (N.D. Ill. 2016).

254. *Entrepreneur Media, Inc. v. Smith*, No. 2:10-mc-55-JAM-EFB, 2013 WL 6185246, at *2, (E.D. Cal. Nov. 26, 2013).

255. *Norman v. Intersango, LLC*, No. 16-cv-03587-YGR, 2016 WL 7325010, at *5 n.3 (N.D. Cal. Dec. 16, 2016).

256. *Petix*, 2016 WL 7017919, at *5.

Moving beyond terminology, courts have labeled cryptocurrencies as currency: “Bitcoin is an electronic form of currency unbacked by any real asset and without specie, such as coin or precious metal,”²⁵⁷ and therefore, “Bitcoin is a currency or form of money.”²⁵⁸

The judicial cases that have addressed the definition and classification of cryptocurrencies have not been, for the most part, focused on cryptocurrency, but instead on the facts and circumstances of the case, with cryptocurrency being regarded as a tertiary issue.²⁵⁹ With the appellate structure of federal courts,²⁶⁰ the issue has not been decided by a higher court.

FinCEN clearly views cryptocurrency as the equivalent of currency to, in its view, properly apply its mission to the expanding cybercurrency market and the related crimes that may be perpetrated.²⁶¹ Both FinCEN and the IRS acknowledge that cryptocurrency is not currency, but it may operate as a de facto currency.²⁶² But while FinCEN’s regulations are intended to ensure those who commit financial crimes are held accountable,²⁶³ the IRS’s regulation instead applies to anyone using, receiving, or investing in cryptocurrency.²⁶⁴

It is not defensible that most individual states have refrained from taking a position on cryptocurrencies, given that under the Constitution, currency is one of the enumerated powers of the federal government.²⁶⁵

Although most regulatory and judicial decisions and statements were made after the IRS issued Notice 2014-21 classifying cryptocurrency as property,²⁶⁶ all the characteristics that these government agencies and courts

257. *Shavers*, 2013 WL 4028182, at *1 (citing *Dion*, *supra* note 21, at 167).

258. *Id.* at *2.

259. *See, e.g.*, *Greene v. Mizuho Bank, Ltd.*, 169 F. Supp. 3d 855 *passim* (N.D. Ill. 2016).

260. States have an appellate structure as well, but Bitcoin cases at the state level are almost non-existent and certainly were not relevant enough to devote a Part to in this Article.

261. *See* FIN-2014-R012, *supra* note 150, at 1, 5.

262. *See* I.R.S. Notice 2014-21, § 2 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html; FIN-2014-R012, *supra* note 150, at 2.

263. *Mission*, *supra* note 144.

264. *See* I.R.S. Notice 2014-21, § 2.

265. U.S. CONST. art. 1, § 8.

266. *See, e.g.*, *SEC v. Shavers*, No. 4:13-CV-416, 2013 WL 4028182, at *1 (E.D. Tex. Aug. 6, 2013).

used to liken cryptocurrencies to currency existed when the IRS made their ruling.

The extensive and overlapping levels of regulation at the federal level (not to mention the additional layers at the state and local levels) are not a new challenge for businesses and consumers. Although there are examples of regulatory divergence when comparing state and federal laws,²⁶⁷ the more typical situation is that laws on the federal level tend to complement each other, as opposed to the conflict that is seen with cryptocurrency. The IRS's classification of cryptocurrency as property is an example of the regulatory discrepancy.²⁶⁸

B. *Fluctuating Value of Cryptocurrency*

Classifying cryptocurrency as property may make sense when the varying valuation of cryptocurrency is considered. In its current form and ecosystem, cryptocurrencies are extremely volatile, sometimes losing hundreds of dollars in value in a single hour—or even more over a day or two—seemingly for no reason.²⁶⁹ While the value of currency remains constant (even while the value of a product may fluctuate),²⁷⁰ the value of a cryptocurrency does fluctuate, sometimes significantly. A dollar in currency will buy what a dollar is worth—\$1 of gas, a bottle of water, etc. It is the value of the item that may increase or decrease, not the value of the dollar.

In 2009, 10,000 Bitcoins were purchased for \$50;²⁷¹ today, one Bitcoin

267. An example of state and federal regulatory conflict is evident in the wide variation and enforcement of marijuana laws, where marijuana is regarded as an illegal Schedule I drug at the federal level but is legally permitted in numerous states for both medical and recreation purposes. See Sarah Jacoby, *Why We Still Have To Put A Disclaimer on All of Our Weed Articles*, REFINERY 29 (Jan. 19, 2017), <http://www.refinery29.com/2017/01/136859/marijuana-state-vs-federal-laws-drug-scheduling>.

268. I.R.S. Notice 2014-21, § 4.

269. See Stan Higgins, *Bitcoin Freefall: Prices Drop Nearly \$200 in 1 Hour*, COINDESK (Jan. 5, 2017), <https://www.coindesk.com/bitcoin-freefall-prices-drop-200/>; David Z. Morris, *Why Bitcoin Just Dropped 30%*, FORTUNE (May 27, 2017), <http://fortune.com/2017/05/27/bitcoin-price-drop/>; Pete Rizzo, *Bitcoin Drops \$300 in One Hour as Price Falls Abruptly and Rebounds*, COINDESK (June 12, 2017), <https://www.coindesk.com/bitcoin-drops-300-one-hour-price-falls-abruptly-rebounds/>.

270. Note that while U.S. currency can fluctuate in reference to other currencies, the federal government does not denote a specific value for one U.S. dollar, even while the government may impact that value through monetary policy.

271. Benjamin Wallace, *The Rise and Fall of Bitcoin*, WIRED (Nov. 23, 2011),

is worth over \$4,600.²⁷² While marketable securities may have fluctuations like this, the U.S. dollar does not. Beyond the substantial long-term appreciation in Bitcoin in the last decade, day-to-day fluctuations can also be volatile. Today, you may need one Bitcoin to buy a computer; tomorrow, the same computer may take less than one Bitcoin, because the value of Bitcoin changes.

The valuation fluctuations of cryptocurrency can provide challenges when treating cryptocurrency like property. When reporting currency transactions to the IRS—for example, in the form of wages, dividend income, or mortgage interest—thought does not need to go into what is the value of the dollar amount being reported. Given the significant valuation fluctuations that can occur daily in cryptocurrencies, that valuation can be troublesome.²⁷³ But IRS forms are not set up to report amounts in cryptocurrency—the cryptocurrency must be converted to a dollar figure in order for a transaction involving cryptocurrency to be reported to the IRS.²⁷⁴

The classification of cryptocurrency as property by the IRS does allow the government to tax cryptocurrency transactions based on its appreciation when a transaction occurs.²⁷⁵ But for the classification as property, any reporting on the transaction to the IRS would be deferred, if not completely avoided.

C. Independent from Government or Quasi-Government Control

In general, and by design, cryptocurrencies are detached from any country or physical backing.²⁷⁶ While some cryptocurrencies may be identified by their connection to or popularity in specific regions or countries, each is distinctly separate from and not controlled by a government or quasi-governmental entity.²⁷⁷ While this provides challenges

https://www.wired.com/2011/11/mf_bitcoin/.

272. *Bitcoin (USD) Price*, *supra* note 90.

273. *Id.*

274. See I.R.S. Notice 2014-21, § 4 (Apr. 14, 2014), https://www.irs.gov/irb/2014-16_IRB/ar12.html.

275. *Id.*

276. See Olivier Garret, *All the Reasons Cryptocurrencies Will Never Replace Gold as Your Financial Hedge*, FORBES (Oct. 26, 2017), <https://www.forbes.com/sites/oliviergarret/2017/10/26/all-the-reasons-cryptocurrencies-will-never-replace-gold-as-your-financial-hedge/#7e0d472e380e>.

277. While some may assume the U.S. Federal Reserve is a government agency, it is a unique combination of government and non-government actors and oversight, best

to the recognition and usage of cryptocurrencies, it also makes cryptocurrencies attractive to many users.²⁷⁸

While independence from government oversight may be beneficial, it can also be considered detrimental to the long-term viability of cryptocurrencies.²⁷⁹ Cryptocurrencies are entirely speculative and have value only while consumers and traders of cryptocurrencies believe they have value.²⁸⁰

The IRS does refer to the fact that virtual currencies are not recognized as legal tender in any jurisdiction. Otherwise, the IRS acknowledges that cryptocurrency is “a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like ‘real’ currency,” says the IRS, without expanding on why the issue of being recognized as legal tender overrides all other characteristics of being considered a currency.²⁸¹

D. Discouraging Use by Applying Property Concepts to Cryptocurrency

Classifying cryptocurrency as property may have a consequence of discouraging its use and impeding the advancement of digital commerce. Classifying cryptocurrencies as property raises several taxation issues or practices that may complicate ownership and use—issues that are not present with currency transactions.

Whenever a taxpayer disposes of property, the taxpayer must determine what the gain or loss is on the transaction.²⁸² The character of that gain or loss is dependent upon whether the asset was a capital asset in the hands of the taxpayer.²⁸³ The same rules would apply to cryptocurrency.²⁸⁴ Users and owners of cryptocurrency must determine if they are holding the

leaving it in the category of quasi-governmental agency. *See Making Sense of the Federal Reserve: Who Owns Reserve Banks?*, FED. RES. BANK ST. LOUIS, <https://www.stlouisfed.org/in-plain-english/who-owns-the-federal-reserve-banks> (last visited Sept. 4, 2017); Wile, *supra* note 133.

278. *See Bitcoin Seeks Recognition From U.S. GAAP*, *supra* note 244.

279. *See United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at *6 (W.D.N.Y. Dec. 1, 2016).

280. *Id.* at *5–6.

281. I.R.S. Notice 2014-21, § 2.

282. I.R.S. Pub. 544, at 5 (Feb. 9, 2017).

283. *Id.*

284. I.R.S. Notice 2014-21, § 4, at A-7.

cryptocurrency as a capital asset or not.²⁸⁵ In Notice 2014-21, the IRS states:

A taxpayer generally realizes capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. For example, stocks, bonds, and other investment property are generally capital assets. A taxpayer generally realizes ordinary gain or loss on the sale or exchange of virtual currency that is not a capital asset in the hands of the taxpayer. Inventory and other property held mainly for sale to customers in a trade or business are examples of property that is not a capital asset.²⁸⁶

So, for example, in the hands of a casual user, Bitcoin would be considered a capital asset. As a capital asset, the user would have to track the basis of each unit of Bitcoin.²⁸⁷ According to IRS Publication 551:

If you can adequately identify the shares of stock or the bonds you sold, their basis is the cost or other basis of the particular shares of stock or bonds. If you buy and sell securities at various times in varying quantities and you cannot adequately identify the shares you sell, the basis of the securities you sell is the basis of the securities you acquired first.²⁸⁸

If, however, the user of cryptocurrency has moved beyond the definition of capital asset and instead uses the cryptocurrency for inventory, then inventory flow assumptions may need to be considered if the taxpayer meets the minimum requirements listed in Publication 538.²⁸⁹ Applying specific identification, LIFO, or FIFO methods to a ledger-based, non-physical asset may lead to inherent problems that are beyond the scope of this Article.

The final challenge for a user of cryptocurrencies would be valuing transactions in U.S. dollars. All transactions, whether capital or inventory, must be reported in U.S. dollars for tax purposes.²⁹⁰ The Internal Revenue Code in general, and Notice 2014-21 specifically, is clear that consumers and businesses are expected to apply these protocols to transactions involving

285. *Id.*

286. *Id.*

287. I.R.S. Pub. 551, at 3 (Jan. 26, 2017).

288. *Id.* at 2.

289. I.R.S. Pub. 538, at 15 (Feb. 9, 2017).

290. I.R.S. Notice 2014-21, § 4, at A-5.

cryptocurrency.²⁹¹

We have seen the improvement of consumer software in products such as Quicken and QuickBooks by Intuit, which have both improved personal financing tracking.²⁹² The financial-services sector has also improved financial tracking and reporting, specifically the tracking of stock basis for consumers, thus making tracking and reporting capital gains and losses easier. If cryptocurrencies continue to grow in popularity, technology will surely find a way to meet the needs of cryptocurrency investors, traders, and users.

VII. CONCLUSION

The IRS has taken the position that cryptocurrencies should be considered property.²⁹³ That position is contradictory to the view of several other federal stakeholders, including courts and regulatory agencies.²⁹⁴ The IRS's position is also contradictory to how users view and use cryptocurrencies, and how the market has accepted cryptocurrencies for the purchase of goods and services.²⁹⁵

While the IRS's decision to classify cryptocurrencies as property may align with the practical position that only the federal government is permitted to coin money, it is not acknowledging the daily function of cryptocurrencies and instead enforcing what some would consider onerous reporting and tracking requirements that could be detrimental to the growth of cryptocurrencies.

291. *Id.* at A-1.

292. See Shelley Elmlad, *The Best Personal Finance Software*, BALANCE (Dec. 23, 2017), <https://www.thebalance.com/best-personal-finance-software-for-windows-pcs-1293825>.

293. *Id.*

294. McKinney, Jr. et al., *supra* note 148 *passim*.

295. See Moreau, *supra* note 35 (stating that some retailers are accepting cryptocurrencies as a form of payment, including Overstock.com, Expedia, Newegg, Dish, and more).