Financial Services

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Reprinted with permission from Tax Notes, July 23, 2018, p. 505

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In this article, the authors discuss the potential application of the wash sale and straddle rules to cryptocurrencies and cryptocurrency-related investments.

The rapid rise of cryptocurrency values since the beginning of 2017 has caused individual investors as well as investment managers and advisers to consider investing in cryptocurrencies and related investments. Heightened attention to the potential tax issues has accompanied this increase.[1]

2018 has also seen a fall in the value of cryptocurrency at times.[2] Buying and selling cryptocurrency in times of price fluctuation can result in losses, sometimes sizable. Certain tax rules may defer the recognition of losses for a variety of asset classes, but whether these rules are applicable to tax losses on cryptocurrency and token dispositions remains an open question. Federal income tax law includes the wash sale and straddle rules, which prevent the immediate recognition of capital losses for tax purposes in some cases. This article discusses the potential application of the wash sale and straddle rules, which could in some cases defer tax losses from cryptocurrencies and cryptocurrency-related investments.

Bitcoin

Bitcoin is the most well-known of more than 1,500 cryptocurrencies.[3] Tokens, which are digital instruments representing a digital asset or utility, are often issued in initial coin offerings (ICOs). Tokens have become popular, and therefore increasingly subject to scrutiny for potential violations of securities and commodities laws and regulations by the SEC and the Commodity Futures Trading Commission.[4] The

[1] *See* Stevie Conlon, Anna Vayser, and Robert Schwaba, "Taxation of Bitcoin, Its Progeny, and Derivatives: Coin Ex Machina," *Tax Notes*, Feb. 19, 2018, p. 1001.

[2] Criminal acts like hacking and fraud can adversely affect the value of these digital assets. *See, e.g.*, Eric Lam, Jiyeun Lee, and Jordan Robertson, "Cryptocurrencies Lose $42 Billion After South Korean Bourse Hack," *Bloomberg* (June 10, 2018).

[3] Wikipedia, "List of cryptocurrencies."

[4] *See* Conlon, Vayser, and Schwaba, "SEC Warns Cryptocurrency Trading Platforms Raise Significant Federal Securities Laws Compliance and Liability Risks," Wolters Kluwer Insights (Apr. 30, 2018).

cryptocurrency market separates tokens into several categories: equity, security, and utility.[5] However, security tokens could be considered a subset of equity tokens that are recognized as subject to SEC regulation as securities. Some equity tokens are called equity convertible tokens, which are generally issued in an ICO and are subsequently convertible into a cryptocurrency.[6] Utility tokens provide access to services.[7]

In addition to buying cryptocurrencies and equity tokens (whether security tokens, equity convertible tokens, or otherwise), investors can invest in cryptocurrencies indirectly. In December 2017 both the Chicago Board Options Exchange (CBOE) and the Chicago Mercantile Exchange (CME) began offering bitcoin futures contracts.[8] Other types of indirect cryptocurrency investments have also been issued, including exchange-traded notes[9] and investment trusts that hold cryptocurrencies.[10]

The IRS has provided limited guidance regarding the tax consequences of cryptocurrency; to date, the only guidance issued has been Notice 2014-21, 2014-16 IRB 938, which covers only "convertible virtual currency" as defined therein. Thus, the notice might not apply to some cryptocurrencies and tokens.

The notice provides that covered cryptocurrency is treated as property for tax purposes, not as currency. This necessitates tracking the cost basis of each purchase of covered cryptocurrency and recognizing gain or loss when sold or exchanged. The character of gain or loss generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer.

Based on the notice, dispositions and exchanges of cryptocurrency can trigger the recognition of gain or loss. Presumably, dispositions and exchanges of tokens could also result in the recognition of gain or loss for tax purposes.

And Wash Sales

If the wash sale rules in section 1091 apply, federal income tax law prevents the immediate recognition of capital losses on the disposition of stocks, securities, and related options, contracts, and shorts. The wash sale rules, first enacted in 1921, are generally triggered if essentially identical stocks or securities — or contracts or options to acquire stocks or securities — are acquired during a 61-day period beginning 30 days before the date of the sale at a loss and ending 30 days after. The wash sale rules prevent the recognition of those losses for tax purposes. Instead, the losses are deferred, and the basis of the newly acquired stocks, securities, or related contracts that trigger the rule is adjusted. Because of the upward adjustment in the basis, the deferred loss is typically recognized in connection with a later disposition of the newly acquired stocks, securities, and related contracts. The basis adjustments result in smaller gains or larger losses in connection with the later dispositions.[11]

Below we examine two types of cryptocurrency transactions and consider whether the wash sale rules might apply. The first example involves a single cryptocurrency or token. Assume that a taxpayer sells one or more "lots" of the cryptocurrency or token at a loss and then acquires additional lots that are essentially identical to those sold at a loss — for example, bitcoin is sold at a loss and more bitcoin is acquired within the 61-day wash sale period.

A second example involves more than one type of cryptocurrency or token. Assume that a taxpayer sells one or more lots of a cryptocurrency or token at a loss and then acquires a different cryptocurrency or token from the one sold for a loss — for example, bitcoin is sold at a loss and the taxpayer acquires Ripple, a

[5] "ICO Tokens: The 3 Different Types," Investory.

[6] Jamie Goldstein, "Token Equity Convertible (TEC) — A New Way to Invest in Crypto Companies," Medium.com (Dec. 4, 2017).

[7] Micha Benoliel, "Understanding the Difference Between Coins, Utility Tokens, and Tokenized Securities," Medium.com (Aug. 8, 2017).

[8] *See* Chicago Board Options Exchange, "CBOE XBT Bitcoin Futures," and Chicago Mercantile Exchange, "CME Group Bitcoin Futures Key Information Document."

[9] Bitcoin exchange-traded notes have been available in Sweden since 2015. Lawrence Carrel, "What the US Can Learn From Sweden About How to Launch a Bitcoin Fund," CNBC.com (Jan. 17, 2018).

[10] For example, the Grayscale Bitcoin Investment Trust, which filed an SEC registration statement that was later withdrawn. Bitcoin Investment Trust, Registration Statement (Form S-1) (May 4, 2017).

[11] Note, however, that the subsequent disposition of the newly acquired stocks, securities, and related contracts can also be subject to the wash sale rule, further deferring the related loss.

different type of cryptocurrency, within the 61-day wash sale period.

The first example frames whether the wash sale rules apply to cryptocurrencies and tokens as a whole, because the same cryptocurrency or token is all but guaranteed to meet the "substantially identical" test. If it is determined that any cryptocurrencies or tokens can be subject to the wash sale rules, the second question frames whether different cryptocurrencies or tokens are substantially identical, and therefore whether the acquisition of a different cryptocurrency or token can trigger the wash sale rules.[12]

The wash sale rules generally apply to stocks or securities and contracts or options to acquire substantially identical stocks or securities.[13] The law does not explicitly define "stocks or securities" for purposes of the rules, prompting the IRS and courts to rely on various sources in defining the term. Section 1236 has sometimes, but not always, been used to define security for purposes of the wash sale rules, although its primary purpose is to set forth special rules for gains from sales or exchanges of securities for dealers. Section 1236(c) defines security for that purpose as "any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing."[14]

Gantner, a 1988 Tax Court case, narrowly construed the definition of security to exclude options for purposes of the wash sale rules.[15] The Tax Court reasoned that Congress amended the definition of security in the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act) to include options, and therefore could have easily done the same in section 1091.[16] Further, no substantial retail options market existed when section 1091(a) was enacted, and no legislative history suggested any intent to include options.[17] Reacting to *Gantner*, Congress amended section 1091(a) to expand the scope of the wash sale rules to include "contracts or options to acquire or sell."[18]

But the IRS has not always looked to a narrow definition of security for purposes of the wash sale rules.[19] In some cases it has applied an analysis focusing on the rules' primary purpose, especially when examining new asset types for which markets previously did not exist.[20] Central to the analysis is whether treating the instrument as being subject to the wash sale rules is consistent with the underlying purpose of preventing tax schemes that attempt to recognize a loss while maintaining an identical or nearly identical investment position.[21] Although *Gantner* makes it clear that this approach is not always successful when litigated, subsequent congressional action suggests that a definition focused on the purpose of the wash sale rules might be equally appropriate.[22]

Some asset types have been found to lie outside the wash sale rules altogether. In Rev. Rul.

[12] A similar question arises in the context of cryptocurrency forks. In other words, is the post-fork cryptocurrency substantially identical to the pre-fork cryptocurrency under the wash sale rules? For a general discussion on the taxability of forks, see Conlon, Vayser, and Schwaba, *supra* note 1, at 1016.

[13] Section 1091(a).

[14] Section 1236(c).

[15] *Gantner v. Commissioner*, 91 T.C. 713, 724 (1988). *See* Erika Nijenhuis, "Wash Sales Then and Now," 4 *J. Tax'n of Fin. Products* 4, 45-46 (Oct. 1, 2003). However, even if the definition of security does not include options, the situation in which a taxpayer "has entered into a contract or option to so acquire substantially identical stock or securities" is still contemplated under the rule. Section 1091(a).

[16] *See Gantner*, 91 T.C. at 724.

[17] *Id.*

[18] P.L. 100-647, section 5075(a) 102 Stat. 3342 (codified as amended at section 1091(a)).

[19] Nijenhuis, *supra* note 15, at 46. *See also* GCM 38285 (Feb. 22, 1980), GCM 38369 (May 9, 1980).

[20] At least one Justice Department probe appears to be examining cryptocurrency price manipulation and other illegal trading practices that influence prices. *See* Matt Robinson and Tom Schoenberg, "U.S. Launches Criminal Probe Into Bitcoin Price Manipulation," Bloomberg.com (May 24, 2018).

[21] *See* GCM 38285. ("We must look to the purpose of the statute in order to determine whether call options should be considered 'stock or securities' for the purposes of the subject case.") The memorandum delineates that while other sections of the code or regulations define the term "securities," an explicit definition is absent from section 1091(a); therefore, in the context of the section's goal, which is "to prevent tax manipulation by a taxpayer who attempts to recognize a loss while maintaining an identical or nearly identical investment position," options should constitute securities for purposes of section 1091(a). *Id.* at 2.

[22] Some see cryptocurrency as especially vulnerable to price manipulation, at least currently. *See* Ryan Browne and Arjun Kharpal, "Cryptocurrency Price Manipulation Is 'Unavoidable,' Head of Crypto Firm Says," CNBC.com (Feb. 13, 2018).

74-218, 1974-1 C.B. 202, the IRS considered whether foreign currency was subject to the wash sale rules.[23] The ruling defines stock and securities for purposes of the wash sale rules by explicit reference to the definition in section 1236(c) noted above.[24] The ruling also provides that a currency is not a stock or security, and that currency "in its usual and ordinary acceptation means gold, silver, other metals or paper used as a circulating medium of exchange." The ruling then concludes that foreign (non-U.S.) currency falls within the definition of currency. Thus, the ruling concludes that foreign currency is not a stock or security subject to the wash sale rules. Note, however, that Notice 2014-21 provides that cryptocurrencies covered by the notice are not considered currencies for federal income tax purposes. And it seems even less likely that cryptocurrency-related tokens would be considered currencies.[25]

Similarly, in Rev. Rul. 71-568, 1971-2 C.B. 312, the IRS held that commodities futures are not subject to the wash sale rules because commodity futures are not stock or securities.

Based on those two published rulings, it is clear that foreign currencies, commodities, and commodity futures are not subject to the wash sale rules. The classification of cryptocurrencies and tokens, being a new type of intangible asset, is uncertain.

The CFTC has issued guidance that some cryptocurrencies may be classified as commodities for purposes of federal commodities regulation, and the SEC has issued guidance that some tokens may be classified as securities for purposes of federal securities regulation. There are concerns that some cryptocurrencies might also be classified as securities for purposes of federal securities regulation, however.[26] The CFTC and SEC acknowledge that determinations of whether a cryptocurrency is a commodity for commodities law purposes or a security for securities law purposes are not mutually exclusive.[27] In other words, some cryptocurrencies or tokens could be simultaneously classified as both a commodity and a security.

Section 2(a)(1) of the 1933 Act defines security to include:

> any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or

[23] In the ruling, the IRS placed currency in a narrow category that excludes other intangible and tangible property. *See* Rev. Rul. 74-218. The IRS has excluded the direct application of Rev. Rul. 74-218 to cryptocurrency by stating that it is property, not currency, leaving open the possibility that cryptocurrency will be categorized as a security. Although cryptocurrency does not appear to clearly fit in the definition of security in section 1236(c), bitcoin exists in intangible form and could be compared with property like street name stocks, or debt in book-entry form. Reg. section 1.1012-1(c)(7). *See* Rev. Proc. 2011-35, 2011-25 IRB 890, discussing the difficulty of transferred basis determination in nontaxable stock acquisitions because of the shift to holding stock in street name.

[24] "Any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing." Section 1236(c).

[25] A substantial body of statements and regulatory commentary has developed, considering many tokens offered for investment purposes to be securities. *See, e.g.*, William Hinman, "Digital Asset Transactions: When Howey Met Gary (Plastic), Remarks at the Yahoo Finance All Markets Summit: Crypto" (June 14, 2018) (noting that "when we see that kind of economic transaction, it is easy to apply the Supreme Court's 'investment contract' test").

[26] The XRP blockchain, for example, remains closely related to Ripple, the company that created it; in contrast, the creators of most blockchains decentralize control of the blockchain. XRP is so much less decentralized than other blockchain-based convertible virtual currencies that some insist it isn't a cryptocurrency at all. Alyssa Hertig, "Is XRP a Security? Major Ripple Debates Explained," coindesk.com (Apr. 8, 2018). Although XRP doesn't purport to represent an equity interest in Ripple, the close ties between the two lead many to believe the SEC might consider it a security. *Id*.

[27] "There is no inconsistency between the SEC analysis [that one or more tokens are securities] and the CFTC's determination that virtual currencies are commodities and that virtual tokens may be commodities or derivatives contracts depending on the particular facts and circumstances." Lav CFTC, "A CFTC Primer on Virtual Currencies," at 14 (Oct. 17, 2017).

right to subscribe to or purchase, any of the foregoing.

Note the breadth of this definition. The SEC has specifically focused on whether specific cryptocurrencies or tokens are considered "investment contracts" that fall under that broad definition of security. *W.J. Howey Co.*, sets forth the so-called *Howey* test that is generally applied to determine whether a contract is considered an investment contract (and therefore a security under federal securities law).[28] Using the *Howey* test, the SEC has concluded that some cryptocurrency-related tokens are securities.

It is important not to generalize about the classification of cryptocurrencies or tokens;[29] each should be assessed based on the facts involved to determine whether it is considered a security or commodity for federal securities and commodities laws. A similar analysis of each cryptocurrency or token is appropriate for assessing its federal income tax classification.

As discussed earlier, while the wash sale rules reference "stock or securities," they do not define the term "stock or securities." Thus, one must consider whether cryptocurrencies and tokens that are classified as investment contracts (and therefore as securities for purposes of U.S. securities regulation) under the *Howey* test could or should be treated as securities for purposes of the wash sale rules.[30]

The IRS and the courts have generally taken two approaches to assessing whether the wash sale rules apply to an instrument: a literal or strict definition approach, and a purpose approach. A literal or strict definition is reflected in the reliance on the section 1236(c) definition of security in Rev. Rul. 74-218, *Gantner*, and similar rulings. That approach might be phrased as: "If considered a commodity, it cannot be a security, therefore wash sale rules are inapplicable."

Under this approach, the wash sale rules would presumably not apply to bitcoin and possibly ethereum based on public statements by SEC officials that these cryptocurrencies are not securities.

However, that approach might be problematic for analyzing whether the wash sale rules apply to specific cryptocurrencies or tokens that might be considered both a security and a commodity for federal securities and commodities law purposes. Similarly, the approach might simply look narrowly at the specific definition of stock or securities in section 1236(c), which limits the application to stocks and various types of debt instruments. In that case, the conclusion that cryptocurrencies or tokens are treated for federal securities law as investment contracts might be irrelevant. The simple question might then be, "Is it stock or debt for tax purposes?" It seems unlikely that most cryptocurrencies should be classified as stock in a corporation or debt instruments based on the extensive case law defining those terms.[31]

Based on the foregoing, it is unclear whether the wash sale rules apply to cryptocurrencies and tokens. Below is a summary of potential outcomes:

1. The wash sale rules cannot apply to a specific cryptocurrency or token if it is considered a commodity rather than a security for purposes of the rules.[32]
2. The wash sale rules cannot apply to any cryptocurrencies or tokens because, regardless of whether they are securities for federal securities law purposes, they are not stock or debt within the meaning of the definition of securities under section 1236(c) as applied for purposes of the wash sale rules.[33]
3. The wash sale rule could apply to a specific cryptocurrency or token if it is considered a security under federal securities law because the definition of a

[28] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

[29] According to public statements made by the SEC's director of corporation finance, a convertible virtual currency could conceivably be a security for purposes of its initial offering and cease to be a security once trading and maintenance is fully decentralized on the blockchain. *See* Hinman, *supra* note 25.

[30] Extensive reporting in 2018 of churning and other cryptocurrency and token market exchanges for significant losses appear to draw attention to the tax policy question whether the wash sale rules should be revised, clarified, or amended to explicitly apply.

[31] *But see* Conlon, Vayser, and Schwaba, *supra* note 1, at 1007 n.45, citing David J. Shakow, "The Tax Treatment of Tokens: What Does It Betoken?" *Tax Notes*, Sept. 11, 2017, p. 1387 (analyzing whether holders of cryptocurrencies are jointly participating in business profits). Certain tokens could possibly be considered stock.

[32] *See* Rev. Rul. 74-218.

[33] Section 1236(c); *see, e.g.*, Rev. Rul. 74-218.

> stock or security under wash sale rules is intentionally vague, and under a purpose definition approach, its classification as a security under federal securities law should cause the rules to apply.[34]

If the wash sale rules apply to one or more cryptocurrencies, the second example discussed above, which involves two different cryptocurrencies, must be considered. The wash sale rules apply not only to identical stocks or securities, but also to substantially identical stocks or securities. Thus, one must consider whether a different cryptocurrency or token acquired during the 61-day wash sale period can be substantially identical to the cryptocurrency or token disposed at a loss.

Unfortunately, the law is murky regarding whether specific stocks or securities are substantially identical.[35] A few noteworthy cases have held that specific stocks and bonds were not substantially identical.[36] However, the analysis has been fact-based, which has created compliance difficulties because of the inability to apply simple rules or safe harbors.[37]

Thus, there is no clear answer for assessing whether the wash sale rules apply to the second example, even for established security types. Analysis of whether some cryptocurrencies or tokens are "substantially identical" promises to be even more complex. Adviser beware!

And Straddles

The straddle rules of section 1092 defer the recognition of losses and can modify the holding period of disposed property subject to the rules.[38] A straddle subject to the rules is defined as "offsetting positions with respect to personal property."[39] Positions are offsetting "if there is a substantial diminution of the taxpayer's risk of loss from holding any position with respect to personal property by reason of his holding one or more other positions with respect to personal property (whether or not of the same kind)."[40]

Personal property subject to the straddle rules "means any personal property of a type which is actively traded."[41] Reg. section 1.1092(d)-1(a) further defines actively traded personal property as including "any personal property for which there is an established financial market." The regulation provides that an established financial market includes:

1. a national securities exchange registered under section 6 of the 1934 Act;
2. an interdealer quotation system sponsored by a national securities association registered under section 15A of the 1934 Act;
3. a domestic board of trade designated as a contract market by the CFTC;
4. a foreign securities exchange or board of trade that satisfies analogous regulatory requirements under the law of its jurisdiction of organization;
5. an interbank market;
6. an interdealer market (as further defined); and
7. solely for debt instruments, a debt market (as further defined).

In determining whether the straddle rules can apply to cryptocurrencies and tokens, the first question is whether cryptocurrencies and tokens are personal property for which there is an established financial market. The second question is whether there are offsetting positions that result in a substantial diminution of risk of loss for that property.

There are two ways that cryptocurrencies or tokens could be considered personal property for

[34] *See, e.g.*, GCM 32835 or if the token is classified as stock for tax purposes.

[35] Nijenhuis, *supra* note 15, at 48.

[36] *See, e.g.*, *Hanlin v. Commissioner*, 108 F.2d 429 (3d Cir. 1939); *Knox v. Commissioner*, 33 B.T.A. 972 (1936); and *Doyle v. Commissioner*, 286 F.2d 654 (7th Cir. 1961).

[37] *See* Nijenhuis, *supra* note 15, at 48-50. Note that the cost basis rules cut this Gordian knot by simplifying broker reporting; brokers are only required to report wash sales on instruments with identical CUSIPs (an acronym for a code that identifies securities, based on Committee on Uniform Security Identification Procedures) or other designated security identification numbers in the same account. Reg. section 1.6045-1(d)(6)(iii)(A).

[38] *See generally* section 1092(a)(1) and reg. section 1.1092(b)-1T and -2T.

[39] Section 1092(c)(1).

[40] Section 1092(c)(2)(A).

[41] Section 1092(d)(1). Although the question whether a specific item of personal property is of a type that is actively traded might be fascinating, we anticipate that availability of market data will in many cases permit a determination.

which there is an established financial market. One way is whether an interdealer market exists. Reg. section 1.1092(d)-1(b)(2)(i) defines an interdealer market as a market that "is characterized by a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers, or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations (including rates, yields, or other pricing information) of one or more identified brokers, dealers, or traders or actual prices . . . of recent transactions." As discussed earlier, the determination of the existence of an interdealer market might differ depending on the cryptocurrency or token that is being analyzed. For example, one could conclude that there is an interdealer market for major cryptocurrencies or for specific tokens. Other cryptocurrencies or tokens might fail this analysis, and therefore fall outside the scope of the straddle rules. Because of changes in the market, a cryptocurrency for which there is no interdealer market in one year might be considered as traded on an interdealer market in a later year (or at a different time).

A second way cryptocurrencies or tokens could be considered personal property is if they are traded on specific national securities exchanges registered under the 1934 Act. As noted, both the SEC and the CFTC have concluded that some cryptocurrencies and tokens are securities or commodities. In March 2018 the SEC issued an alert reminding cryptocurrency market participants that the classification of some cryptocurrencies or tokens as securities for federal securities law purposes could require cryptocurrency exchanges to register with the SEC. Coinbase, the leading cryptocurrency exchange, has been exploring exchange registration.[42] Other cryptocurrency and token exchanges might be considering similar action. These registrations could cause one or more specific cryptocurrencies or tokens to be considered actively traded personal property because of the specified exchange aspects of the regulation described above. The status of registrations could also change from one year to the next.

The second question is whether there are offsetting positions and substantial diminution of risk.

In December 2017 both the CME and the CBOE began trading futures contracts on bitcoin.[43] These contracts permit the shorting of positions in bitcoin. Thus, a taxpayer could hedge long positions in bitcoin with short positions in bitcoin futures, creating offsetting positions that could result in a substantial diminution of risk, which could trigger the application of the straddle rules. As other types of contracts creating short positions in cryptocurrencies and tokens are issued — and as the markets begin to offer futures on cryptocurrencies other than bitcoin — the risk of loss deferrals under the straddle rules could grow.

At least one security offering SEC disclosure expects the section 1256 rules to apply to CME and CBOE bitcoin futures.[44] However, direct holdings in bitcoin are not subject to section 1256 rules. Thus, different tax rules could apply to the different positions that could make up a bitcoin straddle. The straddle rules include special provisions for so-called mixed straddles, in which at least one (but not all) of the positions is a section 1256 contract. Thus, it is important to consider the special mixed straddle rules and their potential application and determine whether a mixed straddle election makes sense.[45]

Nevertheless, the emergence of cryptocurrency futures in December 2017 has permitted the creation of offsetting positions, and the definition of actively traded property raises a

[42] *See* Dave Michaels, "Cryptocurrency Firm Coinbase in Talks to Become SEC-Regulated Brokerage," *The Wall Street Journal*, Apr. 6, 2018. Although no registration has been completed, Coinbase may initially register as a broker-dealer, which would allow operation of a licensed electronic trading system subject to less stringent regulations than those governing national exchanges under 15 U.S.C. section 78f. *Id.*

[43] As noted above. *See* "CBOE XBT Bitcoin Futures" and "CME Group Bitcoin Futures Key Information Document." Ethereum futures may be next. Micheal del Castillo, "An Ethereum Future? U.S. Commodities Giants Lie in Wait After SEC Surprise," Forbes.com, June 18, 2018.

[44] *See, e.g.*, Proshares Trust II, "Pre-Effective Amendment No. 1 to Form S-1 Registration Statement (Form S-1A)," at 50 (Dec. 27, 2017) ("The Sponsor expects that each Fund will invest in Bitcoin Futures Contracts on either the CFE or CME or both through the life of each Fund and thus, the Sponsor expects substantially all of each Fund's futures contracts and foreign currency forward contracts to qualify as Section 1256 Contracts.").

[45] The straddle rules are complex. A detailed discussion of the mixed straddle rules, among other aspects of those rules, is beyond the scope of this article.

concern that some cryptocurrencies and tokens could be subject to the straddle rules. Moreover, changes in market activity and product offerings, as well as SEC initiatives that could trigger cryptocurrency exchange registration, could increase the risk that some cryptocurrencies and tokens might be treated as personal property for which there is an established financial market. If so, the straddle rules would apply and could defer the recognition of tax losses for some cryptocurrencies and tokens in the future.

Oh My!

Cryptocurrencies and tokens issued in ICOs have existed for less than 10 years. Substantial growth in both valuation and activity characterized cryptocurrency and token markets throughout 2017 and early 2018.

Cryptocurrency and ICO token regulation is nascent, and there are evolving concerns based on new regulatory pronouncements under both federal securities and commodities laws.

The evolution of broadly available product offerings and change in valuations raise the risk of tax losses. Widespread tax losses naturally lead to concerns regarding whether rules like the wash sale rules and the straddle rules could disallow or defer the recognition of losses. The treatment of many cryptocurrencies as property rather than currency under IRS Notice 2014-21 and recent SEC guidance treating some tokens (and possibly some cryptocurrencies) as securities for federal securities law purposes raises concerns about whether the wash sale rules could apply to disallow losses in certain cases. Also, the issuance of cryptocurrency futures, the availability of trading data, and possible exchange registration actions raise concerns that straddle rules could also result in loss disallowance. Recent SEC statements suggest that, at the very least, the wash sale rules may be inapplicable to bitcoin and ethereum. Unfortunately, without clear safe harbors and guidance, there is no one-size-fits-all tax law answer. The level of comfort, risk, or concern might differ from one cryptocurrency or token to another because of specific facts. Tax advisers should be prepared to roll up their sleeves and dig into the details to analyze these issues. Oh my!

P.S. We will have to wait for guidance to determine if the lions in the forest are cowardly, and if there was really nothing to be scared about. ■

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