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In this report, the authors examine some of the potential U.S. tax consequences faced by individual U.S. investors and intermediaries who participate in atomic swaps, token swaps, token conversions, cryptocurrency swaps, or cryptocurrency exchanges.

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I. Introduction

An often-repeated philosophical question is: "If a tree falls in the forest and no one hears it, does it make a sound?"

This report examines potential U.S. tax consequences for individual U.S. investors who participate in atomic swaps, token swaps, token conversions, cryptocurrency swaps, or cryptocurrency exchanges.[1] It also discusses gaps in the third-party tax reporting for those transactions and addresses some cross-border considerations for individual investors, given the borderless nature of the cryptocurrency markets.

In light of the reporting gaps, some have argued that particular transactions provide an opportunity for tax evasion. However, it is important to remember that unlike cash transactions, blockchain technology generally retains an established ownership record for all token and cryptocurrency transactions.

A. Background and Definition of Terms

On March 23 the IRS reminded taxpayers that "virtual currency transactions are taxable by law just like transactions in any other property" and that the failure to properly report them can subject taxpayers to tax penalties, interest, and potential criminal charges for tax evasion or filing false tax returns.[2] In that announcement, the agency noted that "because transactions in virtual currencies can be difficult to trace and have an inherently pseudo-anonymous aspect, some taxpayers may be tempted to hide taxable income from the IRS." The announcement was preceded by news reports indicating that as of mid-February, less than 100 tax returns had been filed reporting cryptocurrency gains and losses.[3]

Then, on July 2, the IRS Large Business and International Division announced a new enforcement campaign to address "noncompliance related to the use of virtual currency through multiple treatment streams, including outreach and examinations."[4] Individuals convicted of tax evasion or filing false tax returns can be sentenced up to five or three years in prison, respectively, and fined up to $100,000.[5]

Under prior law, it was argued that exchanges of cryptocurrency might qualify for like-kind treatment under section 1031, which would defer recognition of gain or loss on the exchange.[6] However, the Tax Cuts and Jobs Act (P.L. 115-97), passed in December 2017, prospectively eliminated nontaxable treatment for like-kind exchanges of personal property. Thus, for swaps, barter exchanges, and other transactions involving the exchange of like-kind personal property occurring in 2018 and beyond, U.S. taxpayers will generally be taxed on those exchanges based on the difference between the basis in the property exchanged and its fair market value at the time of the exchange. As discussed later, it appears doubtful that any other tax law rules generally defer recognition of cryptocurrency- and token-related gains on like-kind exchanges.

Notice 2014-21, 2014-16 IRB 938, issued in March 2014, provides basic information (in the form of FAQs) on the federal tax implications of transactions in, or transactions that use, virtual currency. The notice characterizes convertible virtual currency as property rather than currency. In light of that characterization and the TCJA's change of the like-kind exchange law, the exchange of one cryptocurrency or digital token for another could result in taxable income. Even if Notice 2014-21 doesn't apply to specific tokens or cryptocurrencies because of its narrow scope, taxable income could be recognized in connection with the exchange of tokens or cryptocurrencies if they are treated as property for tax purposes.

[1] Outside the United States, many governments have promulgated guidance concerning the regulatory and tax treatment of cryptocurrency-related transactions. Additional guidance has been issued under joint activities and task forces between regulatory bodies and other financial organizations of multiple jurisdictions internationally. This report does not discuss or address that guidance. Lot relief, forks, and other tax issues discussed in our prior report are also not covered here.

[2] IR-2018-71. IRPAC noted estimated cryptocurrency related U.S. tax liabilities of $25 million or 2.5 percent of tax gap. IRS Pub. No. 5315, Catalog Number 71819H, IRPAC Public Report October 2018 (Oct. 24, 2018).

[3] *See, e.g.*, Evelyn Cheng, "Barely Anyone Is Paying the Taxes They Owe on Their Bitcoin Gains," CNBC, Feb. 13, 2018; and Anna Irrera, "Few American Reporting Cryptocurrency Trading to IRS for Now: Report," Reuters.com, Feb. 13, 2018.

[4] IRS, "IRS Announces the Identification and Selection of Five Large Business and International Compliance Campaigns" (July 2, 2018).

[5] Sections 7201 and 7206.

[6] *See, e.g.*, American Institute of CPAs, "Comments on Notice 2014-21: Virtual Currency Guidance" (June 10, 2016) (noting that guidance would be appreciated about distinguishing factors between virtual currencies for section 1031 purposes).

B. Atomic, Token, and Cryptocurrency Swaps

An atomic swap is a direct (rather than intermediated) exchange by two parties of cryptocurrency or other blockchain-distributed property interests.[7] A key element of an atomic swap is its so-called hash time-lock feature, which means that if the referenced cryptocurrency or digital asset isn't delivered within a specified period, the transaction is canceled and no exchange will take place. This feature facilitates the exchange of cryptocurrencies or digital tokens without the parties having to trust an intermediary or third party.

A token swap is simply the exchange of a token for another digital asset. These types of transactions occur for a host of reasons. For example, an investor might be offered digital tokens in an initial coin offering (ICO), and the issuer or investors might decide that a different token is preferable. In other words, the originally issued tokens might be swapped for a different token or other cryptocurrency. The terms of token swaps are generally arranged after the original tokens are issued or acquired. With the substantial number of past ICOs and expected ones, token swaps seem likely.

A token conversion is the exchange of a token for a new token or cryptocurrency that was contemplated in the ICO. This typically occurs when the project funded by the ICO reaches a predetermined technological milestone. The investor exchanges the token originally received for the related cryptocurrency or other digital asset. The terms of a future token conversion are usually specified when the token is initially acquired. The prearranged exchange terms embedded in or related to the ICO token originally received might be viewed as similar to a convertible instrument,[8] as a separate option to later acquire the related cryptocurrency,[9] or as an open transaction,[10] such as a forward contract.[11] However, in some cases, the conversion terms may change between issuance and conversion.

The distinction between these types of conversions can be illustrated through two examples. Storj undertook a token swap in which it exchanged its original tokens, which ran on a bitcoin-based platform, for new tokens on an alternative ethereum-based platform. Tron, on the other hand, sufficiently developed its own technological platform, the Tron Mainnet. Following the launch of the Tron Mainnet, Tron's original ethereum-based tokens were exchanged for new tokens on the new platform, as originally contemplated.

A cryptocurrency swap is simply the exchange of one cryptocurrency for another. These types of transactions often occur in connection with portfolio rebalancing. For example, an investor may hold one or more coins and want to trade them for a different cryptocurrency to manage risk exposure because of the old coins' decrease in value. With the cryptocurrency market continuing to grow and new coins continuing to be introduced — and given bitcoin's decreases in value at various times in 2018 — these types of swaps and exchanges also appear to be increasing.[12]

The fact that these transactions are all borderless is significant. As electronic transactions, they can occur anywhere within the global internet. An atomic swap can take place between an investor who is a U.S. taxpayer and a counterparty who is located anywhere in the world. And even if a token or cryptocurrency swap involves an intermediary, such as an

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[7] Note that for purposes of this report, the term "swap" will generally be used to mean the exchange of one thing for another, rather than a notional principal contract.

[8] The established tax treatment of convertible debt is long-standing but has been criticized by commentators. *See* reg. section 1.1001-3(c)(2)(ii); and Rev. Rul. 72-265, 1972-1 C.B. 222. *See also* Michael Shulman and Nathan Tasso, "Changes to Derivatives 'Pursuant to Their Terms' (Part 1)," *Tax Notes*, May 1, 2017, p. 653; and *Rose v. Trust Co. of Georgia*, 77 F.2d 355 (5th Cir. 1935).

[9] A separate option for tax purposes would need to be valued and separately tracked for gain and loss purposes. It might be argued that exercise of that option could be nontaxable based on case law involving real estate options and IRS guidance regarding stock options. *See, e.g.*, Rev. Rul. 67-96, 1967-1 C.B. 195.

[10] Open transaction and forward contract tax law has been controversial. *See* Robert Willens, "Insight: Monster Founder McKelvey's 'VPFC' Found to Be a 'Forward Contract,'" BNA *DTR*, Oct. 4, 2018.

[11] Proper characterization of token conversions represents difficult questions of first impression, with changes in conversion terms post-issuance potentially raising significant modification issues under section 1001. These issues and the tax treatment of conversions generally (regardless of how characterized) are not intended to be fully addressed in this report.

[12] Note that there are more than 1,700 different cryptocurrencies in existence today.

exchange, investors can engage in transactions with (or facilitated by) exchanges located anywhere. In fact, many cryptocurrency exchanges are located outside the United States, and there is focus on whether one or more countries might become the locations of choice for cryptocurrency exchanges and activities (such as Bermuda, Malta, or Gibraltar).[13]

II. Core-Related U.S. Tax Considerations

A. Do Any U.S. Tax Rules Defer Gain?

As mentioned at the outset of this report, the TCJA's amendment of the like-kind exchange rule of section 1031 to exclude like-kind exchanges of personal property is significant. Cryptocurrencies and tokens are intangible personal property as a matter of property law. Accordingly, the amendment means that for transactions occurring in 2018 and beyond, like-kind exchanges of cryptocurrencies and tokens no longer qualify for tax-free exchange treatment under section 1031. It's therefore worthwhile to examine whether other tax rules might defer the recognition of gain or loss on exchanges of cryptocurrencies or tokens.

B. Exchange Taxation Under Section 1001

Section 1001 generally provides for recognition of gain or loss on the sale or exchange of property. Section 1001(c) states that "the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized." Gain or loss is measured by comparing the amount realized on the sale or exchange with the adjusted basis of the property sold or exchanged. Section 1001(b) generally provides that the amount realized is "the sum of any money received plus the fair market value of the property (other than money) received."

Federal income tax regulations treat some modifications of instruments as not giving rise to taxable exchanges. For example, reg. section 1.1001-3 provides safe harbor treatment such that some modifications of debt instruments do not give rise to taxable exchanges under section 1001. In general, the ultimate consideration, as stated by Justice Thurgood Marshall in the Supreme Court's *Cottage Savings* decision, is that "an exchange of property gives rise to a realization event so long as the exchanged properties are 'materially different' — that is, so long as they embody legally distinct entitlements."[14] Thus, if the exchanged properties embody legally distinct entitlements, their exchange gives rise to a taxable exchange. Here, it is presumed that token or cryptocurrency A is different from cryptocurrency or token B and that each embody legally distinct entitlements. Accordingly, it is reasonably assumed that the exchange or swap of cryptocurrency or token A for B is a taxable exchange for purposes of section 1001.

Cottage Savings and the referenced regulations address section 1001 in exchanges of and modifications to debt instruments. A recent decision by the Second Circuit, *McKelvey* (reversing a Tax Court decision), addressed whether modification of the terms of a prepaid variable forward contract resulted in a significant modification triggering the recognition of gain or loss under section 1001.[15] The court of appeals determined that the substantial payment made for the modification, combined with the change in contract dates, rendered the modification significant enough to constitute an exchange. Further, the Second Circuit panel relied on a probability analysis to determine whether the amount of shares deliverable under the new agreements was fixed, and therefore whether the new agreements were variable prepaid forward contracts or simple forward contracts.[16]

It is not necessary for cash to be received on an exchange of property for the exchange to be taxable. As described above, gain or loss is calculated on an exchange by comparing the

[13] Some even go as far as to suggest building a floating island as its own special economic zone, complete with its own government and cryptocurrency. *See* Camille Bianchi, "A Floating Pacific Island Is in the Works With Its Own Government, Cryptocurrency, and 300 Houses," CNBC, May 18, 2018.

[14] *Cottage Savings Association v. Commissioner*, 499 U.S. 554, 566 (1991).

[15] *Estate of McKelvey v. Commissioner*, No. 17-2554 (2d Cir. 2018).

[16] Unlike most prepaid forward contracts, which may constitute a constructive sale under section 1259(c)(1)(C), the "significant variation" in the amount of deliverable or referenced shares means that a variable prepaid forward contract should generally qualify for open transaction treatment. *See* Stevie D. Conlon and Aquilino, *Principles of Financial Derivatives: U.S. and International Taxation*, section B.102 (1999); *see also* Rev. Rul. 2003-7, 2003-1 C.B. 363; and *Anschutz Co. v. Commissioner*, 664 F.3d 313 (10th Cir. 2011), *aff'g* 135 T.C. 78 (2010).

amount realized with the adjusted basis of the property exchanged. The amount realized is the sum of the amount of cash and the FMV of the property (other than money) received. Similarly, the receipt of property in barter transactions generally gives rise to taxable income, despite no cash changing hands.[17]

To the extent cryptocurrencies and tokens are considered property for federal income tax purposes and each particular token or cryptocurrency is legally distinct from one another, their exchange would be taxable under section 1001 unless an exception applies. The exchange of property is generally taxable whether conducted on an exchange through an intermediary, in a sandlot, or directly between two parties electronically. Thus, the swaps described earlier, including atomic swaps, should generally give rise to taxable gain or loss, except when a specific rule provides otherwise.

C. Federal Income Tax Classification as Stock

Neither the courts nor IRS guidance have yet addressed whether a cryptocurrency or token is stock for federal income tax purposes. The determination of whether a financial instrument is stock, debt, or something else for tax purposes can be difficult because the law is unclear.[18] The seminal U.S. tax treatise on the taxation of corporations and their shareholders, by Boris I. Bittker and James S. Eustice, provides:

> Ordinarily, a share of "stock" embodies the permanent proprietary ownership or equity interest in a corporation, entitling the holder to (1) share proportionately in the profits of the business; (2) vote on matters affecting the corporate enterprise;[19] and (3) share ratably in the assets of the venture (after payment of debts) upon liquidation (although the vote can be absent and preferred stock generally is limited in its equity participation).[20]

In contrast, Bittker and Eustice note that hybrid securities can lack some of the classic features of stock. Much has been written about hybrid securities and their classification as stock or debt over the past 30 years. Many of those securities have been issued on the basis that they are taxed as stock.[21] Although section 385 was added to the code in 1969 to provide clarity, this has generally proven futile, as illustrated by Treasury's recent proposal to remove part of the latest set of section 385 regulations.[22] A similar lack of guidance plagues practitioners attempting to fully classify cryptocurrencies and tokens for tax purposes.

The inherent difficulty of classifying hybrid securities leads to two important observations concerning cryptocurrencies. First, the classification of a cryptocurrency or token as stock for tax purposes parallels in broad brush the issue of whether a cryptocurrency or token is a security for securities law purposes. However, that classification may be inconsistent. In other words, a cryptocurrency or token might not be considered stock for federal income tax purposes even though it could be considered a security subject to federal securities laws. Importantly, a cryptocurrency or token could be classified as a security because it falls within the definition of an investment contract for securities law purposes based on the *Howey* test, rather than as a "stock"

[17] For general discussion, see Burgess J.W. Raby and William L. Raby, "Barter Transactions and the Tax Collector," *Tax Notes*, Nov. 24, 1997, p. 949; and Robert I. Keller, "The Taxation of Barter Transactions," 67 *Minn. L. Rev*. 441 (Dec. 1982).

[18] A parallel inquiry can be made regarding whether a financial instrument represents an equity interest in an entity other than a corporation, such as a partnership or an investment trust. Federal income tax law includes many specific rules for transactions involving partnership interests, for example. Applicable tax law provides that gain or loss may not be recognized in specified related transactions. *See, e.g.*, section 721. This report does not address those issues (or the applicable law), but they should not be overlooked.

[19] Contrast the voting rights of classic common stock with the lack of such under the *Howey* test. *See SEC v. Howey Co.*, 328 U.S. 293 (1946).

[20] Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, para. 12.11 (7th ed. 2015 with updates through July 2018).

[21] *See, e.g.*, David C. Garlock, *Federal Income Taxation of Debt Instruments*, para. 102 (2017). *See also* Michael L. Schler, "BEPS Action 2: Ending Mismatches on Hybrid Instruments, Part 1," *Tax Notes*, Aug. 12, 2014, p. 697.

[22] Final, temporary, and proposed regulations under section 385 were released to immediate controversy on October 13, 2016. *See* T.D. 9790; REG-108060-15; and Lee A. Sheppard, "The Fate of the Debt-Equity Regulations and State Taxes," *Tax Notes*, Dec. 19, 2016, p. 1395. A variety of organizations recommended that Treasury identify the section 385 regulations as burdensome under Executive Order 13789. *See, e.g.*, "SIFMA Identifies Complex, Burdensome Regs for Treasury's Review" (June 2, 2017); and "AICPA Targets Regs for Elimination or Revision" (May 16, 2017). REG-130244-17, published September 24, proposes the removal of the documentation rule governing characterization of some related-party obligations as debt or equity.

per se.[23] Second, the classification of each cryptocurrency or token for federal income tax purposes would presumably be based on the facts and circumstances. This means, for example, that one cryptocurrency or token might be classified as a stock or security while another might not.

For simplicity, the following discussion presumes that a particular cryptocurrency or token is not considered stock for federal income tax purposes.

D. Federal Income Tax Classification as Debt

Determining whether an instrument is indebtedness for tax purposes is similarly challenging. The case law is unclear in many respects, and the future status of the section 385 regulations creates additional concerns.[24] The IRS did issue Notice 94-47, 1994-1 C.B. 357, providing its general analysis of some instruments as debt or equity, which listed specific factors considered by the IRS. The first factor was whether there was "an unconditional promise to pay a sum certain on demand or at a fixed maturity date that is in the reasonably foreseeable future." In general, cryptocurrencies and tokens wouldn't satisfy this first factor for debt characterization, so for purposes of the following discussion, it is also assumed that a particular cryptocurrency or token is not considered debt for federal income tax purposes.

E. Inapplicability of Existing Gain Deferral Rules

There is a more nuanced question lurking below the surface. The corporate tax reorganization rules apply to "stocks and securities," and there is a specific meaning of those terms for these purposes.[25] The lengthy history of whether stock rights and warrants constituted stock for tax purposes may prove informative in analyzing whether cryptocurrencies or tokens may constitute stock or securities.[26] No clear tax law guidance provides that an investment contract under federal securities law is necessarily a stock or security for purposes of the code's corporate tax rules.[27] Based on the assumption that a cryptocurrency or token, while property, is neither stock nor debt for federal income tax purposes, several existing tax rules deferring the recognition of taxable gain can be analyzed.

1. Exchanges of stock for stock in the same company.

Section 1036 provides that "no gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation." This rule does not address the exchange of stock in one corporation for stock in another. Thus, it would not generally provide relief from the taxation of exchanges of different cryptocurrencies or tokens, even if they were classified as stock for federal income tax purposes.[28]

2. Tax-free exchange rules for corporations.

The code provides special rules that can defer the recognition of gain on some exchanges and distributions of stock in different corporations if various rules and requirements are met.[29] One fundamental requirement of these rules is that deferral treatment applies only for stock, securities, and stock rights. If tokens or cryptocurrencies don't constitute stock or debt for federal income tax purposes, it seems highly unlikely that they would meet this requirement.

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[23] The *Howey* test, discussed later, broadly characterizes whether an agreement is an investment contract and thus a security for purposes of U.S. federal securities regulation, focusing generally on whether the agreement involves the investment of funds with an expected return based on the actions of a third party. *See Howey*, 328 U.S. 293. *See also supra* note 19.

[24] *See supra* note 22, discussing the uncertain history and future of the section 385 regulations. Stable coins are outside the scope of this report.

[25] Bittker and Eustice, *supra* note 20, at para. 12.11.

[26] Note the significant tax law history related to the treatment of stock rights as stock for subchapter C purposes. *See, e.g.*, James M. Lynch, "Treatment of Options and Warrants in Tax-Free and Taxable Transactions," 77 *Taxes* 46-63 (1999).

[27] The question whether an investment contract is stock for securities law purposes has been litigated. For example, the Fourth Circuit distinguished particular limited liability company membership interests, stock, and investment contracts, reasoning that the term "stock" is intended to cover a narrow range of instruments with common characteristics, whereas Congress intended "investment contract" as a catchall for "the range of novel and unusual instruments." *Robinson v. Glynn*, 349 F.3d 166, 172-173 (4th Cir. 2003).

[28] Under some circumstances, two different cryptocurrencies or tokens could be considered different series of stock in the same corporation, such as if participants in an ICO issued two entirely separate sets of tokens (assuming the sets of tokens constituted stock for federal income tax purposes).

[29] *See, e.g.*, section 368(a) concerning corporate reorganizations.

III. Information Reporting of Gains

The federal tax law imposes various income tax-related information reporting requirements (Form 1099) on different persons. This information provides a primary mechanism for the IRS to cross-check accurate tax reporting by individual U.S. taxpayers. However, the specific reporting requirements are generally added in response to particular concerns. Accordingly, information reporting can apply in some cases and not in others. That seems to be the case for cryptocurrencies and tokens; information reporting may apply in some cases and not others, or only to specific cryptocurrencies or tokens.

A. Form W-2 and 1099-MISC Reporting

Notice 2014-21 explicitly provides that cryptocurrency mining activity and exchanges of cryptocurrency for services can give rise to Form W-2 and Form 1099-MISC reporting obligations (along with related withholding obligations).[30]

B. Form 1099-B and Cost Basis Reporting

It should be considered whether Form 1099-B reporting obligations, requiring brokers and barter exchanges to report proceeds from (and in some cases, basis for) transactions, apply to specific cryptocurrency-related transactions carried out by online cryptocurrency exchanges. There are two separate issues: Are gross proceeds on the specific sale or exchange subject to information reporting, and is the cost basis of the sold or exchanged property also reported such that the amount of gain or loss on the sale can be readily determined?

1. Gross proceeds reporting.

Sales or exchanges of securities for cash by brokers are subject to information reporting on Form 1099-B under section 6045. Section 6045(a) broadly imposes on brokers a Form 1099-B reporting obligation for gross proceeds, and it grants the IRS regulatory power to decide the details. Reg. section 1.6045-1 provides key definitions establishing the scope of Form 1099-B reporting in terms of who is a broker and what triggers cost basis reporting.[31] Brokers must generally report cash sales of securities, commodities, options, regulated futures contracts, securities futures contracts, or forward contracts — including redemptions of stock and retirements of debt instruments — and entries into short sales.[32] If virtual currencies are not considered one of those types of assets, Form 1099-B reporting would not apply. However, the question remains: Should virtual currency transactions that are not for services or reportable on Form 1099-K, "Payment Card and Third Party Network Transactions," be subject to information reporting?

As noted, Form 1099-B reporting generally applies to sales of commodities by brokers for cash. Under the Form 1099-B reporting regulations, the term "commodity" has a specific definition: "Any type of personal property or an interest therein . . . the trading of regulated futures contracts in which has been approved by the Commodity Futures Trading Commission."[33] That rule was first promulgated in 1983.[34] Then Congress passed the Commodity Futures Modernization Act of 2000,[35] which changed the CFTC's role from strictly controlling market conduct to overseeing exchanges and market participants. In connection with that change, section 5c was added to the Commodities Exchange Act (CEA).

After enactment of the Commodity Futures Modernization Act in 2000, exchanges were allowed to self-certify that new types of contracts met the requirements of the CEA and related regulations as an alternative to obtaining CFTC approval.[36] In December 2017 bitcoin future contracts began trading on the Chicago Board Options Exchange (CBOE) and the Chicago Mercantile Exchange (CME) after the exchanges provided self-certification for those contracts.[37] In

[30] Conlon, Anna Vayser, and Robert Schwaba, "Taxation of Bitcoin, Its Progeny, and Derivatives: Coin Ex Machina," *Tax Notes*, Feb. 19, 2018, p. 1001. Notice 2014-21 also states that Form 1099-K reporting can apply.

[31] Reg. section 1.6045-1(a).

[32] Reg. section 1.6045-1(a)(9).

[33] Reg. section 1.6045-1(a)(5)(i).

[34] T.D. 7873.

[35] P.L. 106-554, Appendix E (Dec. 21, 2000).

[36] *Id*. at section 113.

[37] *See* CBOE, "CBOE XBT Bitcoin Futures"; and CME, "CME Group Bitcoin Futures Key Information Document."

its summary of background information for bitcoin futures, the CFTC indicated that the "vast majority" of new products are approved through this self-certification process.[38] A related CFTC press release indicates that there was "rigorous communication" between the CFTC, the exchanges, and others and that "significant enhancements to contract design and settlement and CME margining" were made as a result of the CFTC's participation.[39]

The issue is whether self-certification of a futures contract under new section 5c of the CEA and the related regulations should have significance for purposes of reg. section 1.6045-1, particularly in light of the change in law in 2000.[40] Does the CFTC's participation in self-certification constitute approval of the trading of regulated futures contracts on bitcoin in connection with introduction of bitcoin futures contracts by the CME and CBOE, such that the related bitcoin falls within the definition of a commodity for purposes of Form 1099-B reporting? In other words, should the regulation be updated to account for self-approval of commodities futures?

A related question: Should self-certification trigger Form 1099-B reporting of sales of the related commodity? Does or should that treatment be limited to specific coins or tokens for which futures contract approval is granted? Or should cryptocurrencies or tokens be broadly treated as commodities in determining whether related sales by brokers for cash are subject to Form 1099-B reporting?

It does seem questionable whether the 2000 change in law permitting self-approval of futures contracts should create a situation under which some new contracts could trigger Form 1099-B reporting of the related commodity while others do not. For commodities law purposes, it should be noted that one district court determined that a specific cryptocurrency (My Big Coin) was a commodity for CEA purposes.[41] The court held that the determination of commodity status for that purpose should be by category, rather than in a specific instance. Since bitcoin futures were being traded, My Big Coin was also a commodity because it was of the same category.

Note that the failure to file Form 1099-B and provide copies to recipients creates potential liability for tax penalties and interest.[42] And if information reporting on Form 1099-B applies, brokers could also be liable for any related backup withholding taxes.[43]

Of course, a critical related issue (discussed later) is whether particular intermediaries fall within the definition of a broker under the regulations.

2. Cost basis reporting.

The cost basis reporting law was enacted in 2008 to raise tax revenue to partially offset anticipated costs to the fisc from the bailout of banks and others after the 2008 global financial crisis.[44] It requires brokers (as that term is broadly defined under applicable law) to annually report the adjusted cost basis of "covered securities" sold for cash during the calendar year in connection with the reporting of the proceeds received. That information is reported to the IRS on Form 1099-B, and investors receive a copy of the form.[45] The definition of covered securities is based in part on the term "specified securities," which includes stock, debt, and options, and securities futures contracts on stock or debt.[46]

The purpose of cost basis reporting was to increase the accuracy of tax reporting of gains and losses in connection with sales of stocks, bonds, and options.[47] There were concerns that calculation complexities created risks of inaccuracies in tax reporting by investors and that

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[38] Commodity Futures Law Reporter, "CFTC Backgrounder on Self-Certified Contracts for Bitcoin Products," at 158, section 34.

[39] CFTC, "CFTC Statement on Self-Certification of Bitcoin Products by CME, CFT and Cantor Exchange," Release 7654-17 (Dec. 1, 2017).

[40] *See* 7 U.S.C. section 7a-2 concerning certification of registered entities.

[41] *Commodity Futures Trading Commission v. My Big Coin Pay Inc.*, No. 18-cv-10077 (D. Mass. 2018); CFTC, "Federal Court Finds That Virtual Currencies Are Commodities," Release 7820-18 (Oct. 3, 2018).

[42] See sections 6721-6724 for penalties related to information returns.

[43] *See generally* section 3406.

[44] Section 403 of the Emergency Economic Stabilization Act of 2008, P.L. 110-343.

[45] Reg. section 1.6045-1(d).

[46] Section 6045(g)(3)(A) and (B); reg. section 1.6045-1(a)(14) and (15).

[47] *See* remarks of Sen. Evan Bayh, 152 *Cong. Rec.* S2196 (Mar. 15, 2006), on the Simplification Through Additional Reporting Tax Act, S. 601 and H.R. 878, 110th Cong. (2007).

the lack of third-party reporting of that information (by brokers) also made it easier for investors to avoid tax.[48]

The related regulations define specified securities subject to cost basis reporting as stock, debt, options on stock or debt, or securities futures contracts.[49] The statute itself is potentially broader in scope. The IRS has explicit discretion in section 6045(g)(3)(B)(iv) to subject other financial instruments to cost basis reporting.[50] Further, section 6045(g)(3)(B)(iii) grants the IRS the ability to apply specified security status to "any commodity, or contract or derivative with respect to such commodity, if the Secretary determines that adjusted basis reporting is appropriate for purposes of this subsection." Thus, the status of cryptocurrencies or tokens as commodities might be significant in assessing whether Form 1099-B gross proceeds reporting of sales is required and whether the rules governing cost basis reporting should apply.

3. Are cryptocurrencies or tokens commodities?

The existing Form 1099-B regulations allow the IRS an easy way to cut the Gordian knot regarding whether self-certification of futures contracts constitutes approval for purposes of reg. section 1.6045-1(a)(5)(i). The Form 1099-B regulations provide that the IRS can designate property as a commodity, applying commodity status to "any other personal property or an interest therein that is of a type the Secretary determines is to be treated as a 'commodity' under this section, from and after the date specified in a notice of such determination published in the Federal Register."[51]

Consider the status of cryptocurrencies or tokens commodities under federal commodities law and regulation. Section 1a(9) of the CEA defines a commodity as follows:

> The term "commodity" means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by the first section of Public Law 85-839 (7 U.S.C. 13-1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.

This definition is broad and extends to many tangible and intangible assets. The CFTC has stated that it believes cryptocurrencies and tokens are in many cases considered commodities and that the related spot markets are subject to CFTC oversight for fraud. Although it might seem that the status of a particular item of intangible property (such as a particular cryptocurrency or token) as either a commodity subject to potential CFTC oversight or a security subject to SEC regulation might be mutually exclusive, that is not the case.[52]

A district court recently concluded that intangible virtual currencies can be commodities for purposes of the CEA and thus subject to enforcement action by the CFTC.[53] That

[48]Conlon, "Re: Proposed Regulations for Cost Basis Reporting for Debt and Options," at n.2 (Feb. 23, 2012) (citing Government Accountability Office, "Capital Gains Tax Gap: Requiring Brokers to Report Securities Cost Basis Would Improve Compliance if Related Challenges Are Addressed," GAO-06-603 (June 13, 2006)).

[49]Reg. section 1.6045-1(a)(14).

[50]*See* section 6045(g)(3)(B)(iv), which permits the IRS to include in the list of specified securities subject to cost basis reporting "any other financial instrument with respect to which the Secretary determines that adjusted basis reporting is appropriate for purposes of this subsection."

[51]Reg. section 1.6045-1(a)(5)(iii).

[52]"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." CFTC, "A CFTC Primer on Virtual Currencies," at 14 (Oct. 17, 2017).

[53]*CFTC v. McDonnell and CabbageTech Corp. d/b/a Coin Drop Markets*, 18-cv-361 (E.D.N.Y. 2018). Note that the CFTC has held the position that virtual currencies such as bitcoin can be subject to regulation as commodities since 2015. *See In re Coinflip*, CFTC Dkt. No. 15-29. *See also My Big Coin*, No. 18-cv-10077 (D. Mass. 2018).

conclusion seems important in assessing whether cryptocurrencies or tokens are commodities that could be subject to Form 1099-B reporting.

4. Are cryptocurrencies or tokens securities?

Although cryptocurrencies are generally considered commodities by the CFTC, a different question is whether cryptocurrencies or tokens are considered securities by the SEC for federal securities law purposes.

This analysis is critical because the Form 1099-B reporting rules do apply to sales of securities. The definition of a security under the related regulations specifically includes:

> (v) An interest in or right to purchase any of the foregoing [specified securities] in connection with the issuance thereof from the issuer or an agent of the issuer or from an underwriter that purchases any of the foregoing from the issuer; and
>
> (vi) An interest in a security described in paragraph (a)(3)(i) or (iv) of this section (but not including executory contracts that require delivery of such type of security).

The definition of a security for federal securities law purposes is broad. It includes "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" and many more items, concluding with "any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."[54]

Note the specific inclusion of "investment contract" within this definition. Investment contracts and other similar arrangements can take various forms.[55] The *Howey* test encapsulates the essence of this inquiry: Any arrangement in which money or other assets are invested with the expectation of profits in a common enterprise from the efforts of a promoter or third party is an investment contract, regardless of whether the investor's interest is represented by formal stock certificates.[56] One specific focus of the test examines whether investment is made "with profits to come solely from the efforts of other."[57]

The breadth of this definition, in combination with the dramatic increase in blockchain investment in 2017, has led to active SEC scrutiny of some cryptocurrency-related assets and activities. This examination and classification remains asset-specific, focusing on one cryptocurrency or token at a time.[58]

The SEC has affirmatively categorized one well-known digital asset, the DAO token, as a security for purposes of federal securities laws.[59] Although the industry described DAO tokens as crowdfunding contracts, the SEC's investigation found the tokens to instead constitute securities.[60]

The SEC's statement summarizing the report on the issue articulates several noteworthy points. First, the offer and sale of securities issued on a blockchain or distributed ledger must be registered unless an exemption applies. Second, participants in unregistered offerings may be violating relevant securities laws. Finally, exchanges providing for trading in blockchain or distributed ledger securities must themselves be registered, unless an exemption applies.

The DAO tokens are not alone in being considered securities by the SEC. As the SEC has stated before, the application of the federal securities laws focuses on how cryptocurrencies,

[54] 15 U.S.C. section 77b(a)(1).

[55] The following discussion provides a summary of potential securities issues previously analyzed in Conlon, Vayser, and Schwaba, "SEC Warns Cryptocurrency Trading Platforms Raise Significant Federal Securities Laws Compliance and Liability Risks," *Wolters Kluwer Insights* (Apr. 30, 2018).

[56] *Howey*, 328 U.S. at 298-299.

[57] *Id*. at 301.

[58] "Investor Bulletin: Initial Coin Offerings," investor.gov, July 25, 2017.

[59] SEC, "SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities" (July 25, 2017).

[60] DAO tokens grew out of a proposal to operate a for-profit distributed autonomous organization through exchange of virtual currencies for DAO tokens, which would allow voting and entitle the holder to rewards, similar to buying shares in a company and receiving dividends. SEC, "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO," Release No. 81207, at 4 (July 25, 2017). Token holders vote on smart contracts (presumably, instead of voting shares for a board of directors). *Id*. The DAO tokens were promoted by several organizations, sold, and were to be traded in the secondary market. *Id*. at 5-6.

tokens, or other digital assets are "issued, distributed, and sold."[61] When digital assets are actively being issued "with the expectation that the promoters will build their system and investors can earn a return on the instrument — usually by selling their tokens in the secondary market," *Howey* most likely applies.[62]

This analysis can change over time, depending on the circumstances of how the asset is marketed and distributed, and it can encompass more than just the qualities inherent to the instrument.[63] Assets with the sole purpose of some utility within a decentralized network could constitute a security if packaged and sold as an investment strategy.[64] Those instruments would be pulled within the scope of the federal securities laws to minimize "information asymmetry between promoters and investors."[65] Preventing those asymmetries is one of the principal purposes of SEC regulation.[66] Certainly, this makes the determination of security classification difficult.[67]

Should the definition of a security under federal securities laws inform understanding of the definition of a security for Form 1099-B reporting purposes? Both regimes ultimately seek to give the public sufficient information to meet its needs — in one case to invest intelligently, in the other to meet its tax obligations.

5. Brokers, barter exchanges, and basis.

Section 6045 imposes information reporting obligations on individuals or entities defined as brokers. Under section 6045(c)(1), a broker is (1) a dealer, (2) a barter exchange, or (3) "any other person who (for a consideration) regularly acts as a middleman with respect to property or services."[68] The applicable regulations broadly define the term "broker" as including "any person (other than a person who is required to report a transaction under section 6043), U.S. or foreign, that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales to be made by others."[69]

The regulations also provide that "a broker includes an obligor that regularly issues and retires its own debt obligations or a corporation that regularly redeems its own stock." Could this apply to the issuer of ICO tokens? The regulations limit the scope of the definition of a broker in the case of non-U.S. persons. Several complicating issues immediately arise. First, even if tokens are considered investment contracts under *Howey*, would the fact that they are not debt or stock per se cause this rule to not apply? Also, what does it mean to "regularly issue and retire its own debt obligations" or "regularly redeem its own stock"?[70]

For tax purposes, a dealer is generally defined as someone who, in the course of her trade or business, regularly offers to buy and sell items to others.[71] Alternatively, some taxpayers may act as

[61] *See* William Hinman, "Digital Asset Transactions: When Howey Met Gary (Plastic)" (June 14, 2018) (remarks of the director of the SEC Division of Corporate Finance); and Stephanie Avakian, "Measuring the Impact of the SEC's Enforcement Program" (Sept. 20, 2018) (remarks of the co-director of SEC Division of Enforcement).

[62] Hinman, *supra* note 61.

[63] *Id*. "I would like to emphasize that the analysis of whether something is a security is not static and does not strictly inhere to the instrument."

[64] *Id*.

[65] *Id*.

[66] "The impetus of the Securities Act is to remove the information asymmetry between promoters and investors. In a public distribution, the Securities Act prescribes the information investors need to make an informed investment decision, and the promoter is liable for material misstatements in the offering materials." *Id*.

[67] Hinman observed that bitcoin and ethereum today appear to be sufficiently decentralized that the projects lack "a central third-party whose efforts are a key determining factor in the enterprise." *Id*. Note, however, that maintenance of bitcoin's code generally happens by the public and can be the focus of heavy scrutiny to determine whether a single group of developers has "taken over." *See*, *e.g.*, "Fact or FUD — 'BlockStream, Inc. Is the Main Force Behind Bitcoin (and Has Taken Over),'" Medium, Nov. 30, 2017. If a small group of developers controlled the majority of changes to the digital technology, would they constitute a third party whose efforts were responsible for changes in value of the digital asset?

[68] Section 6045(c)(1) includes an exclusion from broker status for persons "with respect to activities consisting of managing a farm on behalf of another person."

[69] Reg. section 1.6045-1(a)(1). Although they seem unlikely to be considered debt obligations, initial coin offerings are probably distinguishable in most cases from "regular" coin offerings.

[70] *Id.* Examples from the regulations reference organizations that regularly issue and retire their own debt, but neither the examples nor published rulings appear to provide significant guidance concerning how much issuance and retirement rises to the level of regularity. *See, e.g.*, LTR 200035008 (referencing the definition without analysis). Although they seem unlikely to be considered debt obligations, ICOs are probably distinguishable in most cases from "regular" coin offerings.

[71] Although the definition of a dealer may vary, a dealer in securities is specifically defined in one regulation as a taxpayer who regularly purchases securities from or sells securities to customers or who regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers, both in the ordinary course of a trade or business. Reg. section 1.475-1(c)(1).

traders or investors. Some cryptocurrency and token intermediaries might be dealers, but others likely would not be because of the limited nature of their activities.

Barter transactions can take place directly between participants or indirectly through so-called barter exchanges.[72] A barter exchange provides "a forum for, and arranges the barter of, goods and services between the members of the exchange."[73] John Doe summonses in 1979 led the IRS to conclude that barter exchange members were not adequately reporting the taxable income from those exchanges.[74] In response to that concern, the 1982 Tax Equity and Fiscal Responsibility Act added reporting for barter exchanges to the Form 1099-B rules. The applicable regulations define a barter exchange as "any person with members or clients that contract either with each other or with such person to trade or barter property or services either directly or through such person."[75]

There are third parties that hold themselves out as facilitating atomic swaps (for example, through counterparty matching), presumably on a commercial basis. It seems appropriate to consider whether those third parties could be considered barter exchanges with existing Form 1099-B reporting responsibilities.

Under the Form 1099-B regulations, a barter exchange must generally report on transactions that it intermediates regardless of whether "payment for property or services is made by means of a credit on the books of the barter exchange or scrip issued by the barter exchange or if the barter exchange arranges a direct exchange of property or services among its members or clients or exchanges property or services with a member or client."[76] Clearly, if cryptocurrency or ICO token intermediaries are considered barter exchanges subject to Form 1099-B reporting, the potential responsibilities and penalty risks referenced earlier would be significant.

The regulations and the Form 1099-B instructions detail the reporting requirement applicable to barter exchanges. They specify that the FMV of property or services received must be reported.[77]

It is also important to remember that section 6045 itself grants the IRS broad latitude in the scope and applicability of Form 1099-B reporting. The law permits the IRS to classify as a broker "any other person who (for a consideration) regularly acts as a middleman with respect to property or services."[78] The scope of reporting that the IRS can require under the statute isn't restricted to cash-only transactions, even outside the context of barter exchanges.[79]

As with barter exchange transactions, information reporting of cryptocurrency and token swaps is likely to be imperfect regardless of whether cautionary reporting is prudent, clarifying guidance is appropriate, or new laws or rules are needed. An "80/20" solution that results in information reporting for many of those swaps may be the best one can hope for. Truly atomic swaps conducted by non-brokers when no intermediary is involved, like direct barter exchanges, will likely escape information reporting even if ultimate discovery results in severe tax-related criminal charges and penalties.[80]

IV. Exchange Location Considerations

Much has been written about the so-called modified territorial tax regime installed as part of

[72] For general discussion, see Keller, *supra* note 17.

[73] *Id.* at 480. Note the reference to property rather than securities or commodities.

[74] *Id.*

[75] Reg. section 1.6045-1(a)(4). Note that the cited regulation further provides that the term barter exchange "does not include arrangements that provide solely for the informal exchange of similar services on a noncommercial basis."

[76] Reg. section 1.6045-1(e)(2)(i). There is an exemption from gross proceeds reporting applicable to barter exchanges that transact less than 100 exchanges per calendar year. *See* reg. section 1.6045-1(e)(2)(ii). However, the regulations further provide that multiple exchanges can be combined in testing this 100-exchange threshold.

[77] Reg. section 1.6045-1(f)(4).

[78] Section 6045(c)(1)(C).

[79] *See* section 6045(a) ("with such details regarding gross proceeds and such other information as the Secretary may by forms or regulations require with respect to such business").

[80] Tax evasion as a result of barter has been prosecuted in high-profile cases. For example, Peter Max, a successful pop artist, pled guilty in 1997 to charges of concealing $1.1 million in income from the IRS, stemming from the barter of his artwork for real estate. *See* Benjamin Weiser, "Pop Artist Peter Max Pleads Guilty to Charges of Tax Fraud," *The New York Times*, Nov. 11, 1997.

the TCJA.[81] However, it is important to remember that U.S. individual resident taxpayers cannot access the corporate tax provisions that carry out specific benefits of that regime.[82] Instead, they remain subject to U.S. income tax on their worldwide income. Accordingly, U.S. individual resident taxpayers who exchange cryptocurrencies or ICO tokens should generally be taxed on gains recognized in connection with those exchanges regardless of where the exchange takes place or where the counterparty is located.

A. Potential Withholding Tax Issues

There are several potentially important withholding tax issues that could be relevant depending on where the crypto-tree falls.

1. FATCA.

The Foreign Account Tax Compliance Act,[83] enacted in 2010, generally requires that a 30 percent withholding tax be collected on "withholdable payments" to foreign financial institutions unless account holders meet specified information, due diligence procedures, and information reporting requirements. Section 1473(1) generally defines withholdable payments as "income-type" payments and some gross proceeds payments. Income-type payments considered withholdable payments are defined as "any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States." Gross proceeds payments are defined as "any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States." Withholdable gross proceeds must be both U.S.-sourced and related to the disposition of property giving rise to interest or dividends.

If cryptocurrency or ICO token exchanges are treated as sales or exchanges of property for federal income tax purposes, they would not generally constitute income-type payments subject to FATCA withholding. And unless a specific cryptocurrency or ICO token is considered debt or stock for tax purposes and the related interest or dividends would be considered U.S.-sourced, FATCA gross proceeds withholding would also not apply. FATCA withholding seems to generally miss cryptocurrencies or tokens unless considered stock.

2. Sourcing of income.

The code's sourcing rules are set forth in sections 861-865 and the related regulations. There is no specific guidance on the sourcing of gains from the disposition of cryptocurrency or ICO tokens. However, section 865 generally sources personal property dispositions by U.S. residents as U.S.-sourced.[84] Cryptocurrency and ICO tokens would likely constitute personal property for these purposes. There is a limited exception in that sourcing rule for sales of intangible property.[85] Are cryptocurrency or ICO tokens considered intangible personal property for these purposes? If all personal property is either tangible or intangible, the answer would seem to be yes. However, definitions of terms under law can be more limited, and the legislative history for section 865 specifies that "intangible property is any patent, copyright, secret process or formula, goodwill, trademark, trade name or other like property."[86]

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[81] Many tax lawyers remain uncomfortable calling the various tax rules added by the TCJA a "modified territorial tax regime." The reference is made here as mere shorthand. *See, e.g.*, Mindy Herzfeld, "Tax Cuts Chaos: Can Congress Fix It?" *Tax Notes*, June 4, 2018, p. 1417; and Jasper L. Cummings, Jr., "GILTI Puts Territoriality in Doubt," *Tax Notes*, Apr. 9, 2018, p. 161.

[82] As indicated at the outset, U.S. individual resident taxpayers are the focus of this report.

[83] FATCA was enacted under section 501 of the Hiring Incentives to Restore Employment Act of 2010, P.L. 111-147. The administration is considering withdrawing gross proceeds withholding, according to statements made by John Sweeney, branch 8 chief, IRS Office of Associate Chief Counsel (International). *See* Stephanie Cumings, "U.S. Burden Reduction Regs, Gross Proceeds Relief Coming Soon," *Tax Notes Int'l*, Oct. 22, 2018, p. 448.

[84] Section 865, which generally sources gains on the disposition of personal property to the United States in the case of U.S. residents and outside the United States in the case of nonresidents, was enacted as part of the Tax Reform Act of 1986. Under prior law, that income was sourced based on where the property was sold, generally where title to the property passed to the purchaser. S. Rep. No. 99-313, at 328 (1986). Tax treaties and their potential implications are not discussed in this report.

[85] Section 865(d). Section 865 provides for other exceptions that are not discussed here.

[86] S. Rep. No. 99-313, at 332. Current section 865(d)(2) defines intangible property as "any patent, copyright, secret process or formula, goodwill, trademark, trade brand, franchise, or other like property."

Thus, if cryptocurrency and ICO tokens are not considered intangible personal property under these rules because of the constrained definition of intangible property referenced in the legislative history, the exception would generally be unavailable, and gain or loss recognized on related dispositions would be U.S.-sourced for U.S. residents. However, even if the exception were to apply to dispositions of cryptocurrency or ICO tokens, the exception is further limited in that it is available only to the extent that payments are "contingent on the productivity, use, or disposition of the intangible."[87] The general sourcing rule applies to non-contingent amounts. This rule likely means that most cryptocurrency and ICO token sales by U.S. residents are treated as U.S.-sourced.

B. Potential Special Taxpayer Reporting Issues

1. FATCA reporting.

FATCA added to the code not only specific withholding rules but also reporting requirements for U.S. individual taxpayers. Section 6038D requires annual reporting on Form 8938 by a U.S. individual if the aggregate value of reportable specified foreign financial assets exceeds $50,000. Section 6038D(d) provides for a penalty of between $10,000 and $50,000 for failure to file or properly complete the form.[88] Accuracy-related and criminal penalties can also apply.[89] Financial accounts with FFIs are reportable.[90] Reportable specified foreign financial assets also include any stock or security issued by a non-U.S. person, "any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person," and any interest in a foreign entity.[91]

At issue is whether a specific non-U.S.-held cryptocurrency or ICO token could be considered a financial instrument or contract held for investment that has an issuer or counterparty that is other than a U.S. person. There is no specific guidance addressing this issue. Accordingly, because of potential tax penalty risks associated with the filing of Form 8938, taxpayers may list cryptocurrency or ICO tokens from non-U.S. issuers or held through non-U.S. exchanges on the form out of an abundance of caution.

2. FBAR reporting.

FATCA reporting on Form 8938 does not relieve U.S. taxpayers of proper and timely filing obligations for Financial Crimes Enforcement Network Form 114, "Reporting of Foreign Bank and Financial Accounts (FBAR)."[92] A U.S. citizen or resident; or a person in, and doing business in, the United States; must file a foreign bank account report if the value of all foreign financial accounts exceeds $10,000 at any time during the calendar year.[93] Reportable foreign financial accounts include a securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a financial institution."[94] The failure to comply with the FBAR reporting requirements can result in civil or criminal penalties.[95] Importantly, the intentional failure to comply can result in a civil penalty of the greater of $100,000 or 50 percent of the balance in the foreign financial account.[96] Criminal penalties can apply as well.[97] Considering the potentially significant amount of FBAR-related penalties, U.S. residents may list cryptocurrency or ICO tokens from non-U.S. issuers or held through non-

[87] Section 865(d)(1)(A).

[88] Section 6038D(g) provides a reasonable cause exception to this penalty.

[89] Reg. section 1.6038D-8(f).

[90] Section 6038D(b)(1).

[91] Section 6038D(b)(2).

[92] FinCEN, "BSA Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts (FinCEN Form 114)," at 31 (Jan. 2017). For a general discussion of FBAR reporting and related issues, see Tax Management, *U.S. Income Taxation of Nonresident Alien Individuals* (Portfolio 907-3rd), Pt. XIII; and Steven Mark Levy, *Federal Money Laundering Regulation: Banking, Corporate and Securities Compliance*, ch. 17 (2017).

[93] 31 U.S.C. section 5314; and 31 C.F.R. sections 1010.306 and 1010.311.

[94] 31 C.F.R. section 1010.350(c). *See* FinCEN, *supra* note 92. Note that a recent House bill provides that blockchain developers or services will not be considered financial institutions unless they exercise control over virtual currencies in the ordinary course of business, directly or through software they maintain, disseminate, or create. Blockchain Regulatory Certainty Act, H.R. 6974, 115th Cong. (2018).

[95] 31 U.S.C. sections 5321 and 5322, and related regulations at 31 C.F.R. reg. sections 1010.810 to 1010.850.

[96] 31 U.S.C. section 5321(a)(5)(c).

[97] *See* 31 U.S.C. section 5322.

U.S. exchanges on the form out of an abundance of caution.[98]

V. Conclusion

Many swaps or other exchanges of cryptocurrency and ICO tokens that occur in 2018 and beyond are likely taxable because section 1031 no longer provides any argument that like-kind exchange treatment can apply. If the exchange is generally taxable, it should be considered whether there are any potentially applicable exceptions from the recognition of taxable gain or loss.[99] Although corporate tax rules that defer the recognition of gain or loss under some circumstances might apply, those rules generally apply only to stock or securities (as those terms are defined for purposes of the rules). The SEC, the CFTC, and federal district courts have concluded that some cryptocurrencies are commodities and that under the *Howey* test, some certain cryptocurrencies or ICO tokens are securities under federal securities and commodities laws. However, there is no specific tax law guidance addressing whether cryptocurrencies or ICO tokens are considered stock or securities for corporate income tax purposes. Further, classification as an investment contract doesn't necessarily infer classification as stock for tax purposes. Thus, in general, it seems clear that in many cases beginning in 2019, the crypto-tree falls in the digital forest.

Does it make a sound? As mentioned earlier, there is no guidance yet from the IRS on whether cryptocurrency or ICO token sales are reportable on Form 1099-B. Again, however, it's noteworthy that the SEC, the CFTC, and federal district courts have classified some cryptocurrencies as commodities and classified some ICO tokens as investment contracts. The potential application of the barter exchange rules (which apply more broadly to barter exchanges of property and services) should also not be overlooked. Rules governing barter exchanges may be particularly relevant for atomic swaps facilitated by intermediaries. Moreover, potential penalty and withholding tax risks on intermediaries that might be accountable for third-party reporting must be considered. It seems appropriate for the IRS to address the potential application of the barter rules and to update the definition of commodity in the 6045 regulations. It seems unlikely that FATCA withholding applies.

Atomic exchanges that don't involve an intermediary would seem to escape the information reporting rules. However, the potential civil and criminal penalties that could be faced by individuals who fail to report taxable gains on those exchanges on their tax returns are severe. Moreover, transactions conducted with non-U.S. counterparties could give rise to prophylactic FATCA Form 8938 and FBAR reporting, given concerns regarding related potential civil and criminal penalties.

Guidance from the IRS and Treasury on these and other issues concerning the U.S. taxation of cryptocurrency and tokens is needed. ■

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[98] Andrew Velarde, "Open Questions About Bitcoin Examined by Official, Practitioners," *Tax Notes*, May 22, 2017, p. 1095. *But see* Kelly Phillips Erb, "IRS Says Bitcoin Not Reportable on FBAR (for Now)," Forbes.com, June 30, 2014.

[99] As discussed in our prior article, for example, prudent practitioners will assess whether the wash sale or straddle rules defer the recognition of loss. *See* Conlon, Vayser, and Schwaba, "Bitcoin, and Wash Sales, and Straddles, Oh My!" *Tax Notes*, July 23, 2018, p. 505.