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### IRS Kills Tax Free Crypto Exchanges? Not Hardly

In 2014, the IRS said crypto was property. Five years went by, and the *next* thing the IRS said was that hard forks were taxable. How about swaps of crypto for crypto guidance? Not so much. There is no official guidance, although we all know that by statute, 1031 now applies *only* to real property. How about for 2017 and prior years? It just isn't clear if you could [claim 1031 exchanges on your 2017 taxes](#). That is why the world sat up when someone from the IRS said—at a conference—that 1031 didn't apply even to those old years. Is that official guidance? Not hardly. An IRS person [said](#) the IRS view was “no” on 1031 for crypto. Suzanne Sinno, an attorney in the IRS Office of the Associate Chief Counsel, made the remark at an American Institute of CPAs conference November 13, 2019.

She worked on the recent cryptocurrency guidance the IRS [issued](#), but this was *not* an official announcement, nor was it “authority” for federal income tax purposes. Besides, shortly thereafter, *another* [IRS official walked back the earlier comments, saying it depends on the facts](#). There is no blanket policy to deny 1031 treatment. Do these “announcements” mean the IRS might push back in an audit? Sure, but didn't we already know that? Yes, particularly given the wild differences in how taxpayers treated—and reported—their crypto trades. The recent IRS reveals are interesting, but to say one cannot claim 1031 treatment for 2017 is overblown.

Section 1031 provides that neither gain nor loss is recognized on an exchange of like-kind property that is used in a trade or business or held for investment. However, Section 1031 does not apply to “stocks, bonds ... notes, [or] other securities or evidences of indebtedness or interest.” According to the

Fifth Circuit Court of Appeals, “the distinction intended and made by the statute is the broad one between classes and characters of property, for instance, between real and personal property.” *Commissioner v. Crichton*, 122 F.2d 181, 182 (5th Cir. 1941), *aff’g* 42 B.T.A. 490 (1940).



This language suggests that a liberal test should be used to determine if two types of property are “like kind.” The IRS at times has taken a narrower interpretation in analyzing exchanges of *tangible* property. For instance, in Revenue Ruling 79-143, the IRS ruled that numismatic coins and bullion-type coins were not “like kind” properties. The IRS noted that numismatic coins may be valued for their condition, age, or beauty in addition to their gold content, whereas bullion coins are valued based on the price of gold.

Similarly, IRS General Counsel Memorandum 38899 explained that gold bullion held for investment was not “like kind” with silver bullion held for investment. The GCM states that gold and silver are different metals, and are used in different ways (gold for investment; silver as an industrial commodity). The GCM emphasizes that a taxpayer who exchanges gold bullion for silver bullion “is not in essentially the same economic situation after the exchange as he or she was in before the exchange.” The IRS could argue that, like gold and silver bullion, cryptocurrencies are subject to different market forces, and are different investments used in different ways.

However, in announcing in 2014 that *all* digital currencies are property, the IRS seemed to indicate they were essentially similar. Other authorities suggest

that when it comes to *intangibles*—such as cryptocurrency seems to be—investments do not need to be subject to identical market forces to qualify for like-kind treatment. For example, in Technical Advice Memorandum 200035005, the IRS surveyed its own Revenue Rulings on like-kind treatment, including the bullion exchange authorities. The IRS noted that “even the narrowest interpretation of the like kind standard *does not require that one property be identical to another or that they be completely interchangeable.*” The IRS concluded that a taxpayer’s exchange of FCC radio licenses for an FCC television license qualified as a like-kind exchange under Section 1031.

The TAM said “the differences in the assigned frequencies are not differences in nature or character, but are merely differences in grade or quality.” This seems significant, because radio and television licenses are arguably not subject to identical market forces. One might even argue that the differences between an FCC radio license and an FCC television license are much *more* significant than the relatively subtle technical differences between a number of types of cryptocurrencies.

The differences between many cryptocurrencies are arguably not differences in “nature and character.” There are arguably more similarities than differences, and some of the historical Section 1031 authorities seem pretty helpful. IRS rulings indicate that a broader application of the like-kind standard is appropriate for intangible property. For example, in Revenue Ruling 67-380, the IRS held that exchanges of baseball player contracts qualified for “like kind” exchange treatment. The IRS also issued informal guidance that exchanges of fishing permits are allowed under Section 1031, “regardless of whether the permit is for a different fishery, a different species of fish, or a different type of fishing gear.” IRS, Fishing Audit Technique Guide (August 2011). IRS regulations even say that a copyright in a novel can be like-kind to a copyright in a different novel.

The IRS might argue that cryptocurrencies are not eligible for like-kind exchange treatment because Section 1031 does not apply to exchanges of “securities.” Whether cryptocurrencies are securities for *securities law* purposes has been hotly debated. A topic that has not had as much attention is whether cryptocurrencies are securities for *tax law* purposes, including Section 1031. Skeptics might argue that Congress did not intend for Section 1031 to apply to liquid investments. Because cryptocurrencies can be traded on exchanges much like stocks and bonds, perhaps they should be treated as securities for Section 1031 purposes? However, the IRS’s analysis of Section 1031’s application to another novel investment product might help.

In the 1960’s and 1970’s, the IRS considered whether whiskey warehouse receipts (“WWRs”) should be treated as securities for Section 1031 purposes. A

whisky warehouse receipt represents a share in a quantity of whisky being aged for future sale. Beginning in the early 1900's, whisky warehouse receipts were sometimes advertised as a risk-free get-rich-quick scheme to investors. They eventually became regulated by the SEC as securities. WWRs and cryptocurrencies seem similar in some ways. The IRS made a preliminary decision not to treat WWRs as securities for Section 1031, and proposed publicizing that decision in a ruling. The IRS said "none of the various Code sections containing definitions of the term 'securities' includes warehouse receipts."

Notably, the IRS said that treating WWRs as securities could be viewed as consistent with Congress' purposes of excluding securities from Section 1031 treatment. The IRS indicated that such treatment might be consistent because of the potential classification by the SEC or state securities regulators of WWRs as securities for securities law purposes. The SEC even told the IRS that if the IRS said WWRs were *not* securities for purposes of Section 1031, it could jeopardize the SEC's position in ongoing litigation that WWRs were subject to its enforcement jurisdiction.

Despite the SEC's plea, the IRS stuck to its conclusion that WWRs were *not* securities for purposes of Section 1031. Yes, that means 1031 swaps were OK. The IRS pointed out that the definition of "securities" for *revenue* purposes should be given a narrower meaning than the definition of that term for *securities law* purposes. The latter involves the exercise of police power to protect the public. Still, to avoid undercutting the SEC's enforcement efforts, the IRS ultimately decided *not* to publish its proposed WWR ruling.

Would the IRS agree with any of this? Perhaps not. But even if the IRS pushes back, they might listen. After all, it is not clear whether the IRS official who mentioned the unpublished "IRS position" on 1031 has communicated any of this to all the thousands of IRS troops out there. Besides, even if the IRS won't listen in an audit, there is always IRS appeals. The IRS Appeals Office is where many tax disputes end up being compromised. The IRS isn't even the last word. The courts are. And if your stakes are big enough, that might be worth the effort.

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