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SEARCHING FOR A COMPROMISE: A CASE FOR THE CRYPTO LIKE-KIND EXCHANGE

John Paul Boyter*

INTRODUCTION

In recent years, cryptocurrencies, cryptoassets, electronic coins, tokens, non-fungible tokens, and other various terms for electronic assets have gained prodigious attention in the financial world. From the spike (and subsequent drop) in value of Bitcoin,¹ to people spending millions of dollars on pixelated pictures of punks,² the market for these assets has been extremely active despite its ups and downs. However, in addition to potential financial success via crypto markets, the development of crypto technology has allowed for a transformation of how individuals and institutions think of currency, financial security, and access to information.³ Demonstrative of this fact is that El Salvador became the first country to accept Bitcoin as legal tender in September 2021.⁴ Despite volatility concerns and economists' criticisms, El Salvador's leaders felt that the advantages of adopting Bitcoin outweighed any disadvantages.⁵ In defense of

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1. See John Edwards, *Bitcoin's Price History*, INVESTOPEDIA (Dec. 20, 2022), [<https://perma.cc/2JYN-7DYN>].

2. See Stephen Graves et al., *The 15 Most Expensive NFTs Ever Sold*, DECRYPT (Feb. 21, 2022), [<https://perma.cc/9B5C-PR6G>].

3. See Serenity Gibbons, *10 Ways Cryptocurrency Will Make the World a Better Place*, DUE (Jan. 17, 2022), [<https://perma.cc/5TQW-KYES>].

4. Santiago Pérez, *IMF Urges El Salvador to Ditch Bitcoin's Legal Tender Status*, WALL ST. J. (Jan. 25, 2022, 5:03 PM), [<https://perma.cc/3LW2-KJY9>].

5. See Ciara Nugent, *El Salvador Is Betting on Bitcoin to Rebrand the Country—and Strengthen the President's Grip*, TIME (Oct. 1, 2021, 9:56 AM), [<https://perma.cc/5GAL-NXZ9>].

the decision, Salvadoran President Nayib Bukele stated that the country's adoption of Bitcoin has allowed for its citizens to enjoy financial freedom that was unavailable prior to Bitcoin's adoption.⁶

While countries like El Salvador are spearheading the way for the longevity of crypto, here in the United States, certain policies are restricting the growth and utility of cryptoassets. The regulatory nightmare and competition between federal agencies to control cryptoassets is just one example.⁷ However, an exploration of the regulatory issues posed by cryptoassets is not the focus of this Comment; rather, the taxation policies that the United States has adopted regarding cryptoassets is one of the major restraints placed on their utility. This Comment advocates for a seemingly small but greatly important change to the current tax treatment of cryptoassets. Because the Internal Revenue Service ("IRS") classifies cryptoassets as property, when a taxpayer exchanges one crypto for another, that taxpayer must recognize any gain or loss due to the transaction.⁸ The average taxpayer who invests in or uses crypto is likely unaware of this fact. Thus, this Comment advocates that the exchange of one cryptoasset for another should qualify as a "like-kind" exchange under § 1031 of the Internal Revenue Code (the "Code"). Succinctly, a like-kind exchange allows taxpayers to defer any gain or loss that results from the exchange of one piece of property for another that is like kind.⁹

This change to the current regime would allow for taxpayers to defer gains on crypto-for-crypto transactions until the exchanged-for asset is ultimately disposed of for a form of property that is not like kind.¹⁰ This is by no means a small ask because the Tax Cuts and Jobs Act of 2017 ("TCJA") revised § 1031 to only allow real property exchanges as like-kind exchanges.¹¹ While it seems blatantly incongruous to only allow

6. *Id.*

7. See Sheelah Kolhatkar, *The Challenges of Regulating Cryptocurrency*, NEW YORKER (Oct. 6, 2021), [<https://perma.cc/V4L2-5KZH>].

8. See I.R.S. Notice 2014-21, 2014-16 I.R.B. 938.

9. I.R.C. § 1031.

10. See *id.*

11. See Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13303(a), 131 Stat. 2054, 2123 (codified as amended at 26 U.S.C. § 1031).

real property and cryptoasset exchanges (perhaps the most dissimilar pair of assets in existence) to qualify as like-kind exchanges, adopting this change would better serve the interests of the tax system and stimulate the development, and in turn, the stability of crypto.

Part I of this Comment explains what a cryptoasset is, as well as the current tax regime applicable to them. Part II defines like-kind exchanges and provides the historical context for the nonrecognition event. It also considers the IRS's recent guidance pertaining to crypto like-kind exchanges. Part III puts forth this Comment's main arguments for allowing crypto-for-crypto exchanges to qualify as like-kind exchanges.

I. WHAT ARE CRYPTOS? HOW ARE THEY TAXED?

For simplicity, this Comment will use the term “cryptoasset” and “crypto” to refer to “cryptocurrency” as contemplated by the IRS.¹² Currently, there is a wide breadth of terminology in the cryptosphere, and even those well-versed in the area may use different terminologies than their peers.¹³ Thus, cryptoasset and crypto are used in this Comment interchangeably to refer to those assets that share the denominational requirements to be considered a cryptocurrency under the IRS's definition of virtual currency: a cryptoasset is (1) “a type of virtual currency” (2) “that utilizes cryptography to secure transactions” (3) “that are digitally recorded on a distributed ledger, such as a blockchain.”¹⁴

12. Moreover, this Comment largely focuses on the two most popular cryptos, Bitcoin and Ether. James Royal & Brian Baker, *12 Most Popular Types of Cryptocurrency*, BANKRATE (Jan. 13, 2022), [https://perma.cc/SN4S-XR JL]. This provides for a much more concise discussion of the claim because, as of the time of writing, there are at least 21,844 cryptos in existence. Josh Howarth, *How Many Cryptocurrencies Are There in 2022?*, EXPLODING TOPICS (Nov. 25, 2022), [https://perma.cc/N94J-G6Z4]. Further, it is not necessarily this Comment's claim that all cryptoassets are created equally, nor should every single crypto be subject to similar treatment. However, because the technology is in its infancy, a taxation policy should be drawn in favor of promoting its development.

13. *Compare Cryptoassets Manual*, GOV.UK (Nov. 3, 2022), [https://perma.cc/67RF-MAM9], with Piyali Chatterjee & Eric Essian, *Demystifying Blockchain, Cryptoassets and Tokenization*, RICHEY MAY & CO. (Feb. 2019), [https://perma.cc/9PMB-S3JZ], and Aashish Pahwa, *What Is a Cryptoasset? Types of Cryptoassets [Ultimate Guide]*, FEEDOUGH (Jan. 15, 2022), [https://perma.cc/EH9D-PUX3].

14. Rev. Rul. 2019-24, 2019-44 I.R.B. 1004.

A. What Are Cryptocurrencies and Why Should We Care?

Before discussing the tax ramifications of crypto transactions, it is necessary to first define both virtual currency and cryptocurrency. The IRS defines virtual currency as “a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value.”¹⁵ Underneath the umbrella of virtual currency, the IRS defines cryptocurrency as “a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.”¹⁶ In the same ruling, the IRS felt that it was necessary to contrast these two definitions with that of foreign currency: “Foreign currency is the coin and paper money of a country other than the United States that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance.”¹⁷ This last definition is particularly interesting considering El Salvador’s adoption of Bitcoin as legal tender.¹⁸

It is important to understand the value of cryptoassets before one can fully realize why the technology should be encouraged and why it is necessary to discover a more efficient tax treatment for it, at the very least, by allowing crypto-for-crypto exchanges to qualify as like kind under § 1031 of the Code. According to Satoshi Nakamoto, the person and/or group responsible for Bitcoin’s creation, an electronic coin is “a chain of digital signatures.”¹⁹ This is a very different, yet similar, way of describing a traditional currency. Traditional currencies have generally either been considered a fiat currency or a commodity currency.²⁰ The former is a currency that is backed by a sovereign, and the value of such is determined by the stability and

15. *Id.*

16. *Id.*

17. *Id.*

18. *Countries Which Allow Cryptocurrency as Legal Tender*, COINMARKETCAP, [https://perma.cc/2ERD-B9LX] (last visited Feb. 7, 2023).

19. SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM 2 (2008), [https://perma.cc/MT5Y-DS7K]; *Who Created Bitcoin?*, BITCOIN MAG. (Oct. 7, 2020), [https://perma.cc/Z6G9-GUQU].

20. Dave Ahern, *Fiat Money vs. Commodity Money: A Breakdown of the Pros and Cons*, EINVESTING FOR BEGINNERS (May 21, 2022), [https://perma.cc/A5P5-9GMR].

reliability of the sovereign that backs the currency.²¹ In contrast, commodity currencies are those that are backed by a physical resource, such as gold or silver.²² The significance of Nakamoto’s definition of an electronic coin is that the value is determined and controlled *solely* by the individuals that use Bitcoin.²³ While this concept is not necessarily novel in the sense that all currencies are in some way affected by the value individuals place in traditional currencies—whether in the sovereign or the physical resource that backs the currency—it *is* novel in the sense that there is literally no other value tied to electronic coins other than what individuals decide they are worth.²⁴ However, this is not to say that Bitcoin and other cryptoassets are valueless. The true value of cryptoassets lies in the process that is used in creating, transferring, and verifying transactions involving cryptoassets. This process is encapsulated in the “blockchain.”²⁵

For brevity, this background will focus on Bitcoin’s use of blockchain. The blockchain acts as a public record that tracks the creation and transfer of every Bitcoin.²⁶ Each time a Bitcoin user makes a transaction with her Bitcoin, it is recorded on the blockchain.²⁷ This transaction is then verified by the “private key” that is attached to the coin and/or “[b]itcoin wallet” and again by the process of “mining.”²⁸ Mining is the combined action of people across the world that confirms pending transactions by solving mathematical equations that prove that the Bitcoin that was transferred or received was initially created on the original public ledger, or blockchain.²⁹ This is truly remarkable because no one group or individual is capable of

21. James Chen, *Fiat Money: What It Is, How It Works, Example, Pros & Cons*, INVESTOPEEDIA (Apr. 19, 2022), [<https://perma.cc/JKN9-C23Y>].

22. *Id.*

23. See Eric Rosenberg, *How Is Bitcoin Valued?*, THE BALANCE (May 22, 2022), [<https://perma.cc/EM9H-YAAE>].

24. See Carla Tardi, *Understanding the Different Types of Cryptocurrency*, SOFI (July 12, 2022), [<https://perma.cc/8ND6-5XHA>].

25. *How Does Bitcoin Work?*, BITCOIN, [<https://perma.cc/7KC3-KTQV>] (last visited Feb. 8, 2023).

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

disrupting the blockchain because each transaction is confirmed or rejected by multiple miners around the globe that are incentivized to verify transactions by receiving Bitcoin as payment.³⁰ Further, each “block” in the blockchain is coded using extremely complex cryptography that disallows transactions that do not fit in seamlessly.³¹ Every Bitcoin ever created can be traced back through each transaction it went through all the way to its inception.³² Essentially, the blockchain and the process of mining have stepped in the shoes of the traditional bank that normally would verify transactions.³³ This fact is what gives Bitcoin and other similar cryptoassets their decentralized nature.

However, keep in mind that coins are just one type of cryptoasset.³⁴ To clarify, “coins” are cryptoassets that are intended to be used as a medium of exchange, and they are created and can only be used on the coin’s “native blockchain.”³⁵ However, “tokens” are digital representations of assets, meaning that the specific token can have different uses.³⁶ Similar to coins, tokens can be used for investment purposes or to make purchases; however, to illustrate the difference, holders of tokens may have additional privileges on certain platforms, such as staking tokens and earning interest, being entitled to view streaming content, and earning loyalty points for retailers that are managed on the same blockchain.³⁷

Another example of a token is the Non-Fungible Token (“NFT”). NFTs are digital representations of, well, anything.³⁸

30. *How Does Bitcoin Work?*, *supra* note 25; Euny Hong, *How Does Bitcoin Mining Work?*, INVESTOPEDIA (May 5, 2022), [<https://perma.cc/FE5E-23TP>].

31. *How Does Bitcoin Work?*, *supra* note 25.

32. *See id.*

33. *See* Aaron Hsieh, Note, *The Faceless Coin: Achieving a Modern Tax Policy in the Changing Landscape of Cryptocurrency*, 2019 U. ILL. L. REV. 1079, 1085.

34. Madana Prathap, *Know Your Cryptocurrency Lingo—Crypto Coins and Tokens Are Not the Same Thing*, BUS. INSIDER INDIA (Dec. 24, 2021), [<https://perma.cc/2BGB-4YA4>].

35. *Id.*

36. *Id.*

37. Jake Frankenfield, *What Are Crypto Tokens, and How Do They Work?*, INVESTOPEDIA (May 20, 2022), [<https://perma.cc/9NAL-84SB>]; Lyle Daly, *What Is Staking in Crypto?*, THE MOTLEY FOOL (Nov. 2, 2022, 10:58 AM), [<https://perma.cc/2YQK-66WG>].

38. Joshua Caswell & Leigh E. Furtado, *NFTs for Estate Planners: Not Just a Token Concern*, PROB. & PROP., Sept./Oct. 2021, at 10, 12.

Literally anything that is digital can be turned into an NFT, including pictures, art, videos, tweets, and even virtual real estate—the oxymoron of the century.³⁹ NFTs are “[n]on-[f]ungible” because each NFT cannot be replaced with anything else—each NFT is individually unique and cannot be substituted or replicated, comparable to a one-of-a-kind baseball card.⁴⁰ The ownership of an NFT is tracked the same way as coins and other tokens; each purchase, sale, or trade is tracked on a blockchain.⁴¹ The mockery of NFTs can easily be put to rest by the massive amounts of money that have been invested in them.⁴² Millions of dollars are being poured into this juvenile market, and unsurprisingly, most people are unaware that *each* transaction an individual makes with a cryptoasset, except for the initial purchase of crypto with fiat currency (at least on the buyer’s side), is taxable.

B. Current Tax Treatment

In the seminal case of *Commissioner v. Glenshaw Glass*, the United States Supreme Court held that a taxpayer is in receipt of income, and subject to taxation on that income, when the taxpayer has an “instance[] of undeniable accession[] to wealth, clearly realized, and over which the taxpayer[] ha[s] complete dominion.”⁴³ Within the Code, gross income is defined as “all income from whatever source derived, including . . . [g]ains derived from dealings in property.”⁴⁴ Cryptoassets are treated as property for federal tax purposes, meaning that any gain that results from “dealing[]” in crypto will be included in the taxpayer’s gross income.⁴⁵ Under § 1001, typical property transactions require that a taxpayer recognize a gain or loss upon

39. *Id.* at 11-12; *Virtual Real Estate NFT | Predecessor of Metaverse*, FINEXTRA (Dec. 31, 2021), [<https://perma.cc/8LK4-FFL2>].

40. Gary P. Kohn, *NFTs and the Law*, L.A. LAW., November 2021, at 19, 20.

41. Caswell & Furtado, *supra* note 38, at 12.

42. *See, e.g.*, Jacob Hale, *Top 10 Most Expensive NFTs Ever Sold*, DEXERTO (Dec. 8, 2022), [<https://perma.cc/WHX2-WYEE>].

43. *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

44. I.R.C. § 61(a).

45. Rev. Rul. 2019-24, 2019-44 I.R.B. 1004; I.R.S. Notice 2014-21, 2014-16 I.R.B. 938.

the exchange of property for either cash, goods, services, or another form of property.⁴⁶

The interpretative regulation of § 1001 provides, “[T]he gain or loss realized from the conversion of property into cash, or from the exchange of property for other property *differing materially* either in kind or in extent, is treated as income or as loss sustained.”⁴⁷ To determine whether a taxpayer has realized a gain or loss, the taxpayer must first determine her amount realized.⁴⁸ § 1001 of the Code states, “The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.”⁴⁹ Then, to determine whether one has realized a gain or loss upon the sale or disposition of her property, one must determine her basis and/or adjusted basis in the property that she exchanged.⁵⁰

Generally, and in the case of cryptoassets, one’s basis in property is the cost of that property at the time the taxpayer acquired it including any transactional fees.⁵¹ Further, because cryptoassets are treated as property, sales or dispositions of cryptoassets will result in either short-term or long-term gains or losses.⁵² Short-term gains or losses are those that are realized after holding the property for less than one year.⁵³ Long-term gains or losses are those that are realized after holding the property for more than one year.⁵⁴ Short-term gains are taxed at the taxpayer’s ordinary income tax rate while long-term gains are taxed at the more taxpayer-friendly capital gains tax rate.⁵⁵

For example, if *A* purchases a Bitcoin for \$50,000 on June 1, 2021, her basis in the Bitcoin is the cost—\$50,000. Then, on August 1, 2021, *A* decides to sell her Bitcoin for \$60,000. The

46. I.R.C. § 1001.

47. Treas. Reg. § 1.1001-1 (2017) (emphasis added).

48. I.R.C. § 1001.

49. I.R.C. § 1001.

50. I.R.C. § 1011; I.R.C. § 1012.

51. I.R.C. § 1012.

52. I.R.S. Notice 2014-21, 2014-16 I.R.B. 938-39.

53. I.R.C. § 1222.

54. I.R.C. § 1222.

55. See *Topic No. 409 Capital Gains and Losses*, IRS (Jan. 26, 2023), [<https://perma.cc/UAH2-6RKS>].

difference between the amount realized—\$60,000—and *A*'s cost basis—\$50,000—results in a \$10,000 gain. Further, because this transaction took place within one year after *A* acquired the Bitcoin, the gain will be subject to *A*'s ordinary income tax rate, meaning *A* realized a short-term gain of \$10,000.

Importantly, however, if *A* were to trade her Bitcoin for either property or services, she must determine whether she realized a gain or loss.⁵⁶ Now is when a plethora of issues arise due to the dichotomy that is the IRS's treatment of cryptoassets as property and the taxpayers' treatment of cryptoassets as currency. For example, an employer, *X*, who compensates *A* for her services with Bitcoin must realize a gain or loss at the time the Bitcoin is transferred. *X* must determine its basis in the Bitcoin transferred and realize a short-term or long-term gain or loss that results from the fair market value of the Bitcoin at the time it is transferred to *A* (or the fair market value of *A*'s services) less *X*'s basis in the Bitcoin. While this may be a typical transaction that results in run-of-the-mill tax considerations for *X*, *A* is likely unaware that she needs to track her basis in the Bitcoin if she ever wants to put it to use.

In a different context, consider if *A* purchased one Bitcoin for \$30,000, and later she purchased another Bitcoin for \$50,000. Then, *A* trades half of a Bitcoin for three Ether.⁵⁷ Which cost basis must *A* use to determine her tax liability? Pursuant to its guidance, the IRS allows taxpayers to specifically identify the units being sold or exchanged,⁵⁸ meaning that if *A* would prefer to have a higher cost basis for the transaction and she can specifically identify which units of Bitcoin she exchanged, she could choose to use the \$50,000 basis. Specific identification requires the taxpayer to show:

- (1) the date and time each unit was acquired, (2) [the taxpayer's] basis and the fair market value of each unit at the

56. I.R.S. Notice 2014-21, 2014-16 I.R.B. 938-39.

57. Ether, or "Eth," is the form of currency that is used on Ethereum's blockchain. VITALIK BUTERIN, ETHEREUM: A NEXT-GENERATION SMART CONTRACT AND DECENTRALIZED APPLICATION PLATFORM 13 (2014), [<https://perma.cc/CF7D-EVV8>]. The distinction between Ethereum, the platform, and Ether, the cryptoasset, is an important one that is discussed further below. See *infra* notes 139-41 and accompanying text.

58. *Frequently Asked Questions on Virtual Currency Transactions*, IRS (Jan. 13, 2023), [<https://perma.cc/AEC3-H7JR>].

time it was acquired, (3) the date and time each unit was sold, exchanged, or otherwise disposed of, and (4) the fair market value of each unit when sold, exchanged, or disposed of, and the amount of money or the value of property received for each unit.⁵⁹

On the other hand, if *A* cannot provide the requisite information for specific identification, she must use the first in, first out (“FIFO”) method.⁶⁰ If a taxpayer uses FIFO, the units disposed of are deemed to be disposed of in chronological order,⁶¹ meaning that *A* would use her cost basis in the Bitcoin she purchased first—\$30,000.

Ignoring specific identification and FIFO, just consider that *A* decides she wants to trade some of her Bitcoin for Ether. For example, say *A* trades one of her Bitcoins (with a basis of \$50,000) for five Ether (valued at \$60,000). Likely unbeknownst to *A*, this is a taxable event. In this case, *A* would realize and recognize a \$10,000 gain taxed at either her ordinary income tax rate or capital gains tax rate depending on how long she held the Bitcoin. Further, the only reason that *A* wanted Ether is so she could purchase an NFT of her favorite pixelated picture, which is valued at four Ether. However, between the time *A* received her Ether and purchased her NFT, her five Ether increased in value from \$60,000 to \$80,000.⁶² Now, one Ether is worth \$16,000 (\$80,000 divided by five Ether); however, when she purchased her Ether, her basis in one Ether was \$12,000 (\$60,000 divided by five Ether). Thus, the purchase of the NFT for four Ether is valued at \$64,000 compared to her basis in those four Ether being \$48,000. *A*’s amount realized—\$64,000—less her cost basis—\$48,000—results in a \$16,000 gain.

To someone untrained in tax matters—specifically the approximate 27 million Americans that own some form crypto⁶³—this might seem preposterous. *A* has to pay tax two

59. *Id.*

60. *Id.*

61. *Id.*

62. This is not as farfetched as it may seem. Compare Bitcoin’s value in January 2021—\$29,405.12—to October 2021—\$66,008.47. *Bitcoin*, COINDESK, [https://perma.cc/BY8Z-K6DS] (last visited Jan. 22, 2023).

63. *Cryptocurrency Information About United States of America*, TRIPLEA, [https://perma.cc/XXE7-NY83] (last visited Jan. 22, 2023).

different times without ever receiving cash, services, or other forms of property. The justification for having to pay tax on exchanges of property that is not like kind stems from a concept deemed the “realization event.”⁶⁴

In *Cottage Savings Ass’n v. Commissioner*, the United States Supreme Court agreed “with the Commissioner that an exchange of property gives rise to a realization event under § 1001(a) only if the properties exchanged are ‘materially different.’”⁶⁵ It is necessary to briefly mention the facts of the case to demonstrate what exactly a “realization event” means. In *Cottage Savings Ass’n*, Cottage Savings exchanged with various savings and loan associations its mortgage interests in 252 single-family homes for separate mortgage interests in 305 single-family homes.⁶⁶ At the time, the Federal Home Loan Bank Board (“FHLBB”) allowed savings and loan associations to abstain from reporting losses “associated with mortgages that are exchanged for ‘substantially identical’ mortgages held by other lenders.”⁶⁷ The purpose of this accounting regulation was to allow for transactions that would generate tax losses while not affecting the economic position of the entity in any substantial way.⁶⁸

In the transaction, the face value of the mortgage interests Cottage Savings exchanged was approximately \$6,900,000, and the fair market value of the mortgage interests Cottage Savings received was approximately \$4,500,000.⁶⁹ Because the mortgage interests that Cottage Savings exchanged had decreased in value by nearly \$2,500,000, Cottage Savings attempted to deduct \$2,447,091 from its income as a loss, representing the difference between the face value of the mortgage interests relinquished and the fair market value of the mortgage interests received.⁷⁰

The Commissioner disallowed the deduction on the ground that the properties exchanged were not “materially different,”—in other words, the properties were like kind—as evidenced by

64. *Cottage Sav. Ass’n v. Comm’r*, 499 U.S. 554, 559-60 (1991).

65. *Id.* at 560; *see also* Treas. Reg. § 1.1001-1 (2017).

66. *Cottage Sav. Ass’n*, 499 U.S. at 557-58.

67. *Id.* at 557.

68. *Id.*

69. *Id.* at 558.

70. *Id.*

the fact that Cottage Savings did not have to report losses on the exchange under the FHLBB accounting regulations because the exchange was for “substantially identical” mortgages.⁷¹ Cottage Savings challenged the Commissioner’s position in the Tax Court, which held that Cottage Savings was entitled to take the deduction because the properties exchanged were “materially different.”⁷² The Sixth Circuit reversed, holding that Cottage Savings did not actually sustain losses, rather than focusing on the “materially different” requirement of § 1001(a).⁷³

Thus, before the Supreme Court, the relevant question was whether the properties exchanged were “materially different” under § 1001(a) and Treasury Regulation § 1.1001-1.⁷⁴ In interpreting the “materially different” requirement for recognition of gain or loss, the Supreme Court held that “properties are ‘different’ in the sense that is ‘material’ to the Internal Revenue Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent.”⁷⁵ The Supreme Court agreed with Cottage Savings and held that the mortgages exchanged were materially different because the loan interests possessed distinct legal entitlements—i.e., the loans were secured by different properties and made to different obligors.⁷⁶ All this to say, properties are materially different—or are not like kind—and require recognition of gain or loss upon exchange “so long as they embody legally distinct entitlements.”⁷⁷

II. DISCUSSION OF § 1031

A. History and Purpose of the § 1031 Like-Kind Exchange

It is important to understand the purpose and development of § 1031 exchanges to see why they should be available for

71. *Cottage Sav. Ass’n v. Comm’r*, 890 F.2d 848, 848, 850 (6th Cir. 1989), *rev’d*, 499 U.S. 554 (1991).

72. *Cottage Sav. Ass’n v. Comm’r*, 90 T.C. 372, 402 (1988), *rev’d*, 890 F.2d 848 (6th Cir. 1989), *rev’d*, 499 U.S. 554 (1991).

73. *Cottage Sav. Ass’n*, 890 F.2d at 855.

74. *Cottage Savings Ass’n*, 499 U.S. at 560.

75. *Id.* at 565.

76. *Id.* at 566.

77. *Id.*

cryptocurrency transactions. Ultimately, the purpose of a like-kind exchange is to allow the taxpayer to defer any gain that would otherwise be recognized upon the initial exchange of like-kind properties to a point in time where the taxpayer exchanges the second property for another that is not like kind.⁷⁸ This allows the taxpayer to simply transfer her basis in the exchanged property to the property exchanged for. For example, if *A* exchanges Blackacre with a cost basis of \$100,000 to *X* for Greenacre, *A*'s basis in Greenacre will be \$100,000. This means that if *A* later exchanges Greenacre for \$200,000 in cash or for \$200,000 worth of stock in a company, *A* will recognize a \$100,000 gain. It is important to realize that *A* does not avoid her tax liability. She merely defers the (potential) tax liability to the point in time in which she disposes of the exchanged-for property for property that is not like kind.

Currently, § 1031 provides:

No gain or loss shall be recognized on the exchange of *real property* held for productive use in a trade or business or for investment if such *real property* is exchanged solely for real property of like kind which is to be held either for productive use in a trade or business or for investment.⁷⁹

However, when the concept was first introduced, section 202(c)(1) of the Revenue Act of 1921 provided that

an exchange of *property, real, personal or mixed*, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized [if the transaction meets certain conditions.]⁸⁰

As discerned from its plain language, if a taxpayer received property, that taxpayer was required to recognize gain or loss if “the property received in exchange ha[d] a readily realizable

78. Julia Kagan, *Like-Kind Exchange: Definition, Example, Pros & Cons*, INVESTOPEDIA (Nov. 30, 2021), [<https://perma.cc/UXU6-UBLF>].

79. I.R.C. § 1031(a)(1) (emphasis added).

80. Revenue Act of 1921, Pub. L. No. 67-98, § 202(c), 42 Stat. 227, 230 (emphasis added).

market value.”⁸¹ However, even if a taxpayer received property with a readily realizable market value, that taxpayer would not have to recognize gain (immediately) if the transaction consisted of like-kind properties and met other requirements.⁸² Initially, in accordance with this old rule, taxpayers were able to enjoy the nonrecognition benefits when trading stocks, bonds, and other similar instruments.⁸³ Congress and others saw this as an abuse of the Code and subsequently amended the provision to exclude stocks, bonds, and similar instruments from the nonrecognition protection.⁸⁴ Further, Congress decided to tax any gain due to the receipt of property other than what was considered like kind (i.e., cash).⁸⁵ There are still passionate debates about whether holders of stocks, bonds, and similar instruments are treated unfairly compared to holders of real estate under the Code.⁸⁶ Nonetheless, Congress made it clear that taxpayers should not be able to use like-kind exchanges to skirt truly realized gain recognition.

When Congress adopted 1921’s version of the like-kind exchange, the main two justifications for it were (1) the avoidance of taxing theoretical gains and losses and (2) the Continuity of Investment Theory.⁸⁷

First, Congress recognized that the purpose of a like-kind exchange is to avoid taxing “paper” gains and losses when merely the form, rather than the substance, of the investment has changed.⁸⁸ Congress stated:

81. § 202(c), 42 Stat. at 230.

82. § 202(c), 42 Stat. at 230; *see also* Marjorie E. Kornhauser, *Section 1031: We Don’t Need Another Hero*, 60 S. CAL. L. REV. 397, 403-04 (1987).

83. Kornhauser, *supra* note 82, at 403.

84. *Id.*

85. *Id.* at 404.

86. *See* Albert B. Crenshaw, *EPIC Built Empire on Foundation of U.S. Tax Code*, WASH. POST (Sept. 1, 1985), [<https://perma.cc/5ZQ2-RP9Y>].

87. Another congressional purpose for the like kind exchange at the time was administrative convenience. LEGISLATIVE HISTORY OF TAX POLICIES SUPPORTING IRC SECTION 1031, FED’N OF EXCH. ACCOMMODATORS [hereinafter FEA LEGISLATIVE HISTORY OF 1031 WHITEPAPER], [<https://perma.cc/Q5HT-AW9F>] (last visited Feb. 11, 2023). This was due to the difficulty of determining the values of the properties exchanged. *Id.* However, this purpose was abandoned only three years later in a 1924 amendment to the statute. *Id.* Although, perhaps this justification holds much greater weight in the context of crypto exchanges. *See* discussion *infra* Section III.D.

88. FEA LEGISLATIVE HISTORY OF 1031 WHITEPAPER, *supra* note 87.

In other words, profit or loss is recognized in the case of exchanges of notes or securities, which are essentially like money; or in the case of stock in trade; or in case the taxpayer exchanges the property comprising his original investment for a different kind of property; but if the taxpayer's money is still tied up in the same kind of property as that in which it was originally invested, he is not allowed to compute and deduct his theoretical loss on the exchange, nor is he charged with a tax upon his theoretical profit. The calculation of the profit or loss is deferred until it is realized in cash, marketable securities, or other property not of the same kind having a fair market value.⁸⁹

In interpreting the legislative history of § 1031, the Second Circuit acknowledged that “Congress was primarily concerned with the inequity, in the case of an exchange, of forcing a taxpayer to recognize a paper gain which was still tied up in a continuing investment of the same sort.”⁹⁰ The same principle holds true today; however, perhaps this principle should have broader application for other forms of investments, such as crypto.

Admittedly, the terms “essentially like money,” “marketable securities,” and “cash” ring an alarm that leads to the reasonable conclusion that crypto is often treated like currency or a cash equivalent, so why should the IRS allow for crypto like-kind exchanges?⁹¹ The short answer is that by classifying crypto as property, it is simply not cash nor essentially like money because an obstacle stands in between the taxpayer and the utility of the crypto—a taxable event.⁹²

Second, recognized as one of the more prominent justifications for § 1031 exchanges is the Continuity of Investment Theory.⁹³ Essentially, this theory holds that after a like-kind exchange, the taxpayer is practically in the same, or very close to the same, position that the taxpayer was in prior to the

89. H.R. REP. NO. 73-704, at 13 (1934).

90. *Jordan Marsh Co. v. Comm’r*, 269 F.2d 453, 456 (2d Cir. 1959). Similarly, the Ninth Circuit found that the legislative history of § 1031 showed that the provision “was designed to avoid the imposition of a tax on those who do not ‘cash in’ on their investments in trade or business property.” *Starker v. United States*, 602 F.2d 1341, 1352 (9th Cir. 1979).

91. *Cf.* H.R. REP. NO. 73-704, at 13 (1934).

92. See *infra* Part III for the long answer and a comparison of stocks and crypto.

93. Erik M. Jensen, *The Uneasy Justification for Special Treatment of Like-Kind Exchanges*, 4 AM. J. TAX POL’Y 193, 199 (1985).

exchange.⁹⁴ While this theory somewhat relies on the illiquidity of the property exchanged,⁹⁵ the essence of the theory is that § 1031 provides a solution for the taxpayer “who is unable or unwilling to sell investment property because of the burden that capital gains and recapture taxes would place on the taxpayer’s cash flow and net worth.”⁹⁶ This justification advances the country’s and individuals’ interests by incentivizing investment efforts and transactional activity.⁹⁷

Both justifications may be read along with each other and are still relevant today.⁹⁸ The synthesis of the two presents a policy that promotes the transferability of the substance of an investment without the hindrance or interruption of a resulting tax liability. However, in 2017, Congress modified § 1031 through the TCJA and narrowed the scope of nonrecognition by limiting like-kind exchanges to only those that are exchanges of real property.⁹⁹

B. Definition of Like Kind

If the tax benefits of § 1031 are only available if the exchanged properties are like kind, what exactly does that mean? Prior to the TCJA, it was sometimes difficult to determine whether property was like kind because exchanges of personal property could potentially seek refuge under § 1031.¹⁰⁰ Prior to the TCJA and now, the IRS considers properties to be like kind “if they’re of the same nature or character, even if they differ in grade or quality.”¹⁰¹ While only real properties may be like kind

94. *Id.*; see also H.R. REP. NO. 73-704, at 13 (1934).

95. Jensen, *supra* note 93, at 199 n.29.

96. FEA LEGISLATIVE HISTORY OF 1031 WHITEPAPER, *supra* note 87.

97. *Id.*

98. *Id.*

99. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13303, 131 Stat. 2054, 2123 (codified as amended at I.R.C. § 1031); INTERNAL REVENUE SERV., U.S. DEP’T OF THE TREASURY, PUBLICATION 544: SALES AND OTHER DISPOSITIONS OF ASSETS 12 (2022), [<https://perma.cc/KZB8-TJY4>].

100. See *Like-Kind Exchanges—Real Estate Tax Tips*, IRS (Nov. 10, 2022), [<https://perma.cc/P3DB-E9JW>].

101. *Id.* Now, however, the inquiry is much clearer. In the same guidance, the IRS states, “Real properties generally are of like-kind, regardless of whether they’re improved or unimproved.” *Id.*

under the current regime, it is helpful to explore the IRS's past guidance and allowances of like-kind exchanges involving personal property.

The relevant portion of the definition of like kind is “same nature or character.”¹⁰² In a 2008 IRS Fact Sheet, the guidance attempted to define what “nature, character or class” meant but failed to do so in any meaningful way.¹⁰³ However, the guidance states, “In personal property exchanges, the rules pertaining to what qualifies as like-kind are more restrictive than the rules pertaining to real property.”¹⁰⁴

Examples of personal property like-kind exchanges allowed in the past include an FCC Radio License for an FCC Television License, baseball player contracts, fishing permits, and coins of the same material.¹⁰⁵ These examples illustrate that the Code allowed for certain exchanges of properties to qualify as like kind even though they possessed arguably much greater differences than two separate cryptoassets. For example, regarding the fishing licenses, the IRS stated, “The exchange of a fishing permit/license for another fishing permit/license qualifies for nontaxable exchange treatment under IRC § 1031, regardless of whether the permit is for a different fishery, a different species of fish, or a different type of fishing gear.”¹⁰⁶ To analogize, the exchange of one crypto for another should qualify for § 1031 treatment regardless of whether the crypto is used on a different platform, to purchase an NFT, or to stake an investment.

C. Held for Investment Requirement of § 1031

Along with being like kind, the exchanged property and the exchanged-for property must both “be held either for productive use in a trade or business or for investment.”¹⁰⁷ For simplicity and relevance, this Comment will focus on property held for

102. *Id.*

103. I.R.S. Fact Sheet FS-2008-18 (Feb. 2008), [<https://perma.cc/CB5Q-SY6T>].

104. *Id.*

105. Eli Cole, *Cryptocurrency and the § 1031 Like Kind Exchange*, 10 HASTINGS SCI. & TECH. L.J. 75, 93-95 (2019).

106. I.R.S. Fishing Audit Technique Guide (Aug. 2011), [<https://perma.cc/X72D-UHK3>].

107. I.R.C. § 1031(a)(1).

investment. Whether property is held for investment depends on the intent of the property holder.¹⁰⁸ The IRS has recognized that cryptos may be held for investment.¹⁰⁹

Notably missing from § 1031 is personal use property.¹¹⁰ This is an important distinction because if a crypto holder is found to hold the crypto for personal use, it will not be subject to this Comment's proposed rule. Personal use property is anything a taxpayer owns and uses for that taxpayer's own benefit and enjoyment.¹¹¹ In contrast, property held for investment is generally understood as property that produces income or appreciates in value.¹¹² While a taxpayer might hold crypto for both investment and personal use, the primary intent of the taxpayer will control.¹¹³ Thus, only those taxpayers whose *primary intent* for holding crypto is for investment purposes will be subject to this Comment's proposed rule.

D. IRS Memorandum Considering Whether Crypto Swaps Prior to the TCJA Qualified as Like Kind

To further complicate achieving this Comment's objective, in a 2021 Memorandum, the IRS plainly stated that crypto swaps made even prior to the TCJA did not qualify for § 1031 treatment.¹¹⁴ The IRS first considered exchanges of Litecoin for Bitcoin or Litecoin for Ether.¹¹⁵ In holding that neither of these transactions were like kind, the IRS stated that Bitcoin and Ether held "special position[s]" compared to other cryptos.¹¹⁶ This position was the "on and off-ramp" for other cryptos, meaning that if a taxpayer wanted to either purchase or sell Litecoin, in the event of a purchase, that taxpayer would have to buy Bitcoin (or Ether) first and use that Bitcoin to purchase Litecoin, or in the

108. See *Bolker v. Comm'r*, 81 T.C. 782, 804 (1983), *aff'd*, 760 F.2d 1039 (9th Cir. 1985).

109. I.R.S. Notice 2014-21, 2014-16 I.R.B. 938.

110. I.R.C. § 1031.

111. Carissa Rawson, *What Is Personal Use Property?*, THE BALANCE (Apr. 27, 2022), [<https://perma.cc/ND5W-L8YD>].

112. See I.R.S. Form 4952 (2022), [<https://perma.cc/U59S-HL62>].

113. See *Bolker*, 81 T.C. at 804.

114. I.R.S. Mem. 202124008, at 1 (June 8, 2021), [<https://perma.cc/U4EW-RPFB>].

115. *Id.*

116. *Id.* at 3.

event of a sale, trade Litecoin for Bitcoin and then ultimately dispose of the Bitcoin for cash.¹¹⁷ The IRS came to the conclusion that this special position that Bitcoin and Ether held “played a fundamentally different role from other cryptocurrencies within the broader cryptocurrency market.”¹¹⁸

Next, the Memorandum contemplated whether a trade of Bitcoin for Ether or vice versa qualified as like kind.¹¹⁹ Again, the IRS concluded that the cryptos were not like kind.¹²⁰ In so concluding, the IRS stated that “while both cryptocurrencies share similar qualities and uses, they are also fundamentally different from each other because of the difference in overall design, intended use, and actual use.”¹²¹ The Memorandum acknowledged that both Bitcoin and Ethereum are intended to be used as “payment network[s]” but found that Ethereum’s additional functionality of operating as a platform for smart contracts and applications made it *fundamentally* different from Bitcoin.¹²²

III. WHY CRYPTO-FOR-CRYPTO SHOULD BE SUBJECT TO § 1031 TREATMENT

A. The (Non)realization Event

The first argument for allowing crypto like-kind exchanges is that swapping one crypto, say Bitcoin, for another, say Ether, does not constitute a realization event as understood in *Cottage Savings Ass’n*. This is so because, contrary to the IRS’s opinion, the cryptos are not “materially different” from one another. As stated previously, properties are materially different if they embody legally distinct entitlements.¹²³ Inescapably, certain cryptoassets have different properties than others. For example, Bitcoin operates as an electronic form of payment intended to be

117. *Id.*

118. *Id.*

119. I.R.S. Mem. 202124008, *supra* note 114, at 3.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Cottage Sav. Ass’n v. Comm’r*, 499 U.S. 554, 566 (1991).

used as a currency on Bitcoin's network,¹²⁴ whereas Ether operates as a currency on Ethereum's platform that enables the use of smart contracts and decentralized applications.¹²⁵ However, while cryptoassets may have different properties, they are *sufficiently* like kind to justify the deferral of any gain realized in a crypto-for-crypto transaction because no gain is truly realized until the cryptoasset is exchanged for a completely different form of property, for services, or for cash.

To state it plainly, Bitcoin and Ethereum do not possess legally distinct entitlements as understood in *Cottage Savings Ass'n*. There, the Court considered that the mortgages exchanged and the mortgages exchanged for derived from loans made to different obligors that were secured by different properties.¹²⁶ The key distinction between the assets considered in *Cottage Savings Ass'n* and cryptoassets is that, in the former situation, the taxpayer was the recipient of a completely different set of rights and a *new* set of entitlements.¹²⁷ However, in the case of crypto, the only difference between holders of Bitcoin and holders of Ether is that the holders of Ether have the *ability* to spend Ether on Ethereum's network to operate smart contracts or applications.¹²⁸ Importantly, this ability does not come with a new set of rights, such as those contemplated in *Cottage Savings Ass'n* or those that accompany the purchase of stock.¹²⁹ Because Ether is simply the "fuel" used on Ethereum's network, when taken out of context of the network, it is just another form of investment nearly identical to that of Bitcoin.¹³⁰

To illuminate the likeness of cryptos, it is helpful to compare legal entitlements that accompany stocks to legal entitlements that accompany decentralized cryptos. In enacting § 1031, Congress clearly did not intend for marketable securities, such as stocks, to

124. NAKAMOTO, *supra* note 19, at 1.

125. BUTERIN, *supra* note 57, at 13.

126. *Cottage Sav. Ass'n*, 499 U.S. at 566.

127. *See id.*

128. BUTERIN, *supra* note 57, at 13.

129. *See Introduction to Ethereum Governance*, ETHEREUM (Feb. 10, 2023), [<https://perma.cc/675J-WXWV>].

130. Nathan Reiff, *What Is Ether (ETH), the Cryptocurrency of Ethereum Apps?*, INVESTOPEdia (Nov. 17, 2022), [<https://perma.cc/46ML-K5CB>].

benefit from like-kind exchanges.¹³¹ However, it is important to understand the reasons why and how those reasons are absent when discussing crypto. To start, a common stockholder of a corporation does not just receive equity in the corporation; rather, the stockholder receives a bundle of rights along with the shares.¹³² These rights include voting power and the right to sue for certain wrongful acts, among others.¹³³ These rights fit neatly within the Supreme Court’s definition of “materially different” properties in *Cottage Savings Ass’n*.¹³⁴ For example, if *A* owns stock in corporation *X*, *A* may participate in shareholder voting for *X* or in lawsuits against *X* and its directors. However, if *A* trades her shares in *X* for shares in corporation *Y*, *A* may no longer participate in shareholder voting for *X*. It is not hard to see why *A*’s investment has changed in substance—she has a completely new and different set of legal entitlements because she can no longer vote in corporate elections for *X*, nor can she sue *X*’s directors for breaches of fiduciary duties.

While certain blockchains may possess some form of governance,¹³⁵ opportunities to vote on the course that a specific crypto technology takes pale in comparison to shareholder voting.¹³⁶ Furthermore, and perhaps more importantly, crypto holders are not entitled to any causes of action against the creators or developers of the technology for mismanagement or breaches of fiduciary duties.¹³⁷ Thus, crypto investors simply have an

131. H.R. REP. NO. 73-704, at 13 (1934).

132. Basia Hellwig, *Know Your Shareholder Rights*, INVESTOPEDIA (May 31, 2022), [https://perma.cc/2HP9-PR3T].

133. *Id.*

134. *Cottage Sav. Ass’n v. Comm’r*, 499 U.S. 554, 566 (1991).

135. See Jake Frankenfield, *On-Chain Governance: Definition, Types, Vs. Off-Chain*, INVESTOPEDIA (Oct. 25, 2021), [https://perma.cc/VZF5-YCEJ].

136. Compare Adam Hayes, *What Are Stockholder Voting Rights, and Who Gets a Vote?*, INVESTOPEDIA (Mar. 21, 2021), [https://perma.cc/ASQ2-TUMA] (discussing how shareholders vote on certain corporate governance issues *annually* for all public corporations), with Frankenfield, *supra* note 135 (discussing how individual crypto holders may participate in scarce, informal governance matters; however, this governance is claimed to be centralized among developers, and the consequences of such centralization led to the hard forks that both Ethereum and Bitcoin went through).

137. See Andrea Tinianow, *When Blockchains Crash, Who Can You Sue?*, FORBES (Feb. 7, 2019, 2:32 PM), [https://perma.cc/4ZN6-JA6K] (discussing how tort law is likely the only remedy for damaged investors and how crypto developers are not fiduciaries because they simply suggest code enhancements that are either accepted or rejected by miners and investors).

economic stake in whatever crypto they own without the participation and legal rights that shareholders of a corporation possess. Because a crypto investor does not avail herself of a separate or new set of rights upon the exchange of one crypto for another, the exchange is not a realization event and thus should not be a taxable event.

B. Rebutting the IRS's Conclusion in Its 2021 Memorandum

The IRS concluded in its 2021 Memorandum that because Ethereum allows for the operation of a payment network as well as the operation of applications and smart contracts on its platform, it cannot be like kind to Bitcoin, whose platform is meant to be used purely as a payment network.¹³⁸ This reasoning is unpersuasive. While the Ethereum *platform* allows for the operation of smart contracts and applications, the actual crypto in dispute, Ether, is the currency that is used on the platform.¹³⁹ Because Ether is simply the crypto that is used on Ethereum's *platform*, the only difference between an Ether and a Bitcoin—other than the underlying ones and zeroes—is the intended use the creators envisioned.¹⁴⁰ However, the overwhelming conduct of those involved in crypto is investment.¹⁴¹

To analogize, consider that an exchange of farmland in central Kansas for an apartment complex in New York City would qualify as like kind.¹⁴² The owners of such properties may have completely different intended uses for the properties; however, as long as the owners hold the properties for *investment*, the inquiry comes to an end, and the owners may defer gain under § 1031.¹⁴³ The point is that as long as the holders of Bitcoin and Ether hold the cryptos for investment purposes, if they exchange one for the

138. I.R.S. Mem. 202124008, *supra* note 114, at 3.

139. Reiff, *supra* note 130.

140. Nathan Reiff, *Bitcoin vs. Ethereum: What's the Difference?*, INVESTOPEDIA (Oct. 4, 2022), [<https://perma.cc/E5KR-2B6W>].

141. See Nathan Reiff, *Why Should Anyone Invest in Crypto?*, INVESTOPEDIA (Aug. 24, 2021), [<https://perma.cc/6BCN-QDEF>].

142. *Like-Kind Property: What Qualifies and What Doesn't*, 1031GATEWAY, [<https://perma.cc/BTU6-ARJD>] (last visited Feb. 11, 2023).

143. Provided the other requirements are met. See I.R.C. § 1031; *Like-Kind Property: What Qualifies and What Doesn't*, *supra* note 142.

other, the nonrecognition allowed in § 1031 should apply. To be clear, this Comment is not advocating for a change in policy regarding real estate like-kind exchanges. Rather, the point is that Congress and the IRS have made a necessary concession in allowing for the deferral of gain in land transactions, even when the pieces of property are drastically different, for good reason. However, going one step further to allow for similar treatment in crypto transactions would only further advance the purposes Congress adopted when it enacted § 1031.¹⁴⁴

Even if the reader does not buy the argument that Bitcoin and Ether are sufficiently similar and agrees with the IRS that, because the two cryptos have different intended uses, they cannot be like kind, the reader should consider the case of swapping Bitcoin for Litecoin. Both Bitcoin's and Litecoin's platforms are intended to be used as payment networks.¹⁴⁵ Now is when the reasoning of the IRS Memorandum appears unavoidably flawed. If *A* swaps one Bitcoin for 400 Litecoins, how has her position changed? Simply put, *A* is in a nearly identical position before and after the exchange even if the value of the 400 Litecoins exceeds *A*'s cost basis in her Bitcoin. This is so because, assuming an arm's length transaction, the one Bitcoin and the 400 Litecoins had equal fair market values. The only difference is the form of crypto that *A* has an economic interest in—*A* has not realized income as defined in *Glenshaw Glass*,¹⁴⁶ nor has she received a new set of legal entitlements as understood in *Cottage Savings Ass'n*.¹⁴⁷

144. See *infra* Section III.C.

145. *What Is Litecoin?*, LITECOIN, [<https://perma.cc/GJ7S-5HPW>] (last visited Apr. 18, 2022). Perhaps an easier bright-line rule would be to only allow crypto like-kind exchanges for cryptos that are not classified as securities. However, whether a certain crypto qualifies as a security is not an easy question to answer. For example, in 2018, then SEC chairman Jay Clayton stated plainly, "Cryptocurrencies: These are replacements for sovereign currencies, replace the dollar, the euro, the yen with bitcoin That type of currency is not a security." Kate Rooney, *SEC Chief Says Agency Won't Change Securities Laws to Cater to Cryptocurrencies*, CNBC (June 11, 2018, 9:35 AM), [<https://perma.cc/JU72-ZZ7F>]. However, when discussing tokens such as Ethereum, Clayton said, "A token, a digital asset, where I give you my money and you go off and make a venture, and in return for giving you my money I say 'you can get a return' that is a security and we regulate that." *Id.*

146. See *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955).

147. See *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 555 (1991).

C. Applying Congress's Justifications for § 1031 to Crypto

First, in light of the “paper” gain justification, Congress recognized the inherent unfairness of taxing individuals whose investment merely changed form rather than substance, even though the individual received property with greater value than the individual’s basis in the exchanged property.¹⁴⁸ In other words, Congress intended to avoid “speculative taxation in the middle of an ongoing investment” when “[a] duplex investment property becomes a six flat, which becomes a strip mall, then a shopping center.”¹⁴⁹

The same reasoning is effortlessly applied in the context of crypto exchanges. When *A* trades her one Bitcoin with a basis of \$50,000 for five Ether with a fair market value of \$60,000, *A* merely has a paper gain. She has simply changed the form of crypto that her financial interest presides in. By requiring *A* to pay tax on the exchange, the IRS is “forcing a taxpayer to recognize a paper gain which was still tied up in a continuing investment of the same sort.”¹⁵⁰

In the same vein, the Continuity of Investment Theory establishes a policy that encourages property exchanges.¹⁵¹ Inherent in this justification is the notion that Congress does not want to prevent a taxpayer from changing the form of her investment because of a potential tax liability. This allows investors to look for more lucrative opportunities in which to invest, which promotes economic stimulus and transactional activity.¹⁵² In real estate transactions, taxpayers commonly trade parcels of real estate because the property the taxpayer is receiving either looks more promising from an economic standpoint or the property simply meets the taxpayer’s desires.

When a taxpayer chooses to invest in one crypto over another, reasons why may include comparative volatility and risk,

148. H.R. REP. NO. 73-704, at 13 (1934).

149. FEA LEGISLATIVE HISTORY OF 1031 WHITEPAPER, *supra* note 87.

150. *Jordan Marsh Co. v. Comm’r*, 269 F.2d 453, 456 (2d Cir. 1959).

151. FEA LEGISLATIVE HISTORY OF 1031 WHITEPAPER, *supra* note 87.

152. *Id.* at 1; Kagan, *supra* note 78.

faith in one technology over another, the ability to use the crypto on a certain network, or mere speculation.¹⁵³ Just as in real estate exchanges, a taxpayer might lose faith in the potential success of her current investment or may believe there is greater potential for success in a different investment. Thus, a logical conclusion follows: taxpayers should be free to swap one crypto for another without incurring tax liability because it would promote transactional activity and economic stimulus.

D. Practical Considerations

Perhaps the most persuasive arguments for allowing a § 1031 crypto exchange are everyday, practical considerations: it would dramatically increase the ease with which a taxpayer assesses his or her tax liability, allow for administrative ease in revenue collection, and stimulate the growth and stability of crypto.

First, a taxpayer who is unaware of the tax classification of crypto is due for a rude awakening come Tax Day if the taxpayer made any transactions with the crypto. In response to this fact, software—e.g., CoinLedger—has been created specifically to track crypto-tax events.¹⁵⁴ However, even so, a survey found that only 54.8% of crypto users reported cryptocurrency on their taxes.¹⁵⁵ This is partly due to tax reporting platforms, such as TurboTax, not having the ability to track crypto transactions across multiple platforms.¹⁵⁶ Further, some accountants lack the knowledge required to advise clients about their crypto transactions.¹⁵⁷ However, even if an accountant possesses the requisite knowledge, it is nonetheless difficult and costly to

153. See, e.g., John Divine, *6 of the Best Cryptocurrencies to Buy Now*, U.S. NEWS (Feb. 3, 2023, 1:38 PM), [<https://perma.cc/5Z8D-56AF>]; Chris Davis et al., *How to Buy Dogecoin (DOGE)*, NERDWALLET (Dec. 20, 2022), [<https://perma.cc/XL7Q-TWSE>].

154. David Yaffe-Bellany & Ron Lieber, *Trade Your Crypto. Buy Your NFTs. And Pay Your Taxes.*, N.Y. TIMES (Mar. 26, 2022), [<https://perma.cc/5FNP-QPF9>].

155. CRYPTOTRADER.TAX, THE STATE OF CRYPTOCURRENCY TAX REPORTING IN 2022, at 3 (2022), [<https://perma.cc/Z2HD-RK8D>].

156. *Id.* at 10.

157. *Id.*

discern a crypto-trader's tax liability if that taxpayer made several transactions with crypto.¹⁵⁸

Consider the hypothetical mentioned previously.¹⁵⁹ *A* must track her basis each time she purchases crypto or receives it for services,¹⁶⁰ discern which specific units of crypto she exchanged or use the FIFO method, find the relevant fair market value of the crypto she is receiving, and finally, determine the difference between the amount realized and her basis.¹⁶¹ As onerous as it seems, this is a relatively simple situation, and this quagmire becomes exceedingly complex when there are multiple exchanges or wallets involved.¹⁶² After suffering a justified headache, *A* might owe a nominal tax.

Second, if taxpayers investing in crypto find it difficult to assess their tax liabilities, it is no surprise that the IRS is struggling similarly in enforcing tax compliance and revenue collection regarding crypto transactions.¹⁶³ If the IRS allowed for crypto like-kind exchanges, it would dramatically decrease the difficulty the agency has faced by removing copious amounts of transactions from the IRS's plate and allow the agency to focus on less transactions that will ultimately result in nearly the same amount of tax being paid. Not only would this increase the IRS's ability to scout for true tax evaders that use crypto, but it would also provide a bright-line rule for taxpayers that is easy to follow.

Finally, if taxpayers are free to exchange cryptos without incurring tax liability, they will inevitably be more likely to do so.

158. *Id.* at 9.

159. *See supra* text accompanying notes 55-64.

160. Remember, even if *A* has only purchased one crypto, Bitcoin, but she has done so multiple times, she must track her basis *with each purchase*. Similarly, if *A* is compensated with Bitcoin multiple times, she must track her basis in each separate receipt of Bitcoin.

161. *See Frequently Asked Questions on Virtual Currency Transactions, supra* note 58.

162. *See* CRYPTOTRADER.TAX, *supra* note 155, at 9.

163. Lynn Mucenski Keck, *How the IRS Is Looking for Its Share of Cryptocurrency and NFT Growth*, FORBES (Feb. 22, 2022, 9:00 AM), [<https://perma.cc/5TCT-QMVN>] (discussing IRS enforcement actions and "John Doe" summonses and how the agency has sent thousands of compliance letters to taxpayers for failure to report crypto transactions). Also, consider that if a taxpayer purchases a cup of coffee from Starbucks with Bitcoin, that taxpayer must determine if she has gain or loss on the transaction because it is an exchange of property for goods. *See* Lionel Laurent, *Bitcoin at Starbucks Is More Meme Than Money*, BQ PRIME (Nov. 17, 2021, 7:40 AM), [<https://perma.cc/3JUB-VYQT>]. This is just another example of how difficult and tedious it is to track crypto transactions.

This will foster the evolution and development of a technology that has the potential to revolutionize the way sovereigns and institutions contemplate currency. If security, privacy, speed, access to information, globalization, and more are the fruits of this technology, U.S. tax policies should not stunt the growth of crypto when it is in its infancy. Naturally, the taxation policy in favor of hindering crypto transactions is preventing further adoption of this technology by institutions, cautious citizens, and taxpayers that do not believe it is worth the frustration that comes with assessing tax liability.¹⁶⁴

CONCLUSION

By adopting crypto-friendly policies, the government could modernize the way individuals and institutions think of currency. The financial security, privacy, and freedom that crypto advocates champion is only the start to what this technology could provide to American citizens, the Nation itself, and the world as a whole. By classifying crypto as property,¹⁶⁵ the IRS has created a complex scheme that is the cause of tax attorneys' and accountants' nightmares. Thus, at the very least, Congress and the IRS should allow crypto swaps to qualify as § 1031 exchanges. While this may not be a perfect nor permanent solution, it adequately balances the interests between revenue collection and taxpayer freedom.

First, this policy would better align with the Supreme Court's definition of what constitutes materially different properties. Second, the congressional justifications for like-kind exchanges are equally present in the context of crypto as they are in real estate transactions. Third, allowing crypto like-kind exchanges would relieve the administrative burden in enforcing compliance and the burden taxpayers face come Tax Day. Finally, investors would not be as skeptical of crypto, and as a consequence, the technology would more quickly develop to a

164. See Rob Garver, *Crypto Tax Compliance Remains Minefield as IRS Leaves Key Questions Unresolved*, COINDESK (Feb. 24, 2022, 9:38 AM), [<https://perma.cc/JD85-2CPS>].

165. To be clear, there may not be a better way to classify crypto. Maybe, in the years to come, a whole section of the Code could be dedicated to such assets to take into account their uniqueness.

point where crypto's ultimate goals are met: the streamlining of existing financial architecture¹⁶⁶ and "putting the power and responsibility in the currency holders' hands."¹⁶⁷

166. Jake Frankenfield, *Cryptocurrency Explained with Pros and Cons for Investment*, INVESTOPEDIA (Feb. 4, 2023), [<https://perma.cc/FT3P-JRUU>].

167. *What Is Cryptocurrency and Blockchain?*, AFS FIN. GRP. (July 30, 2021), [<https://perma.cc/F8KD-RECS>].