Cryptocurrencies and the Definition of a Security for Code Sec. 1091

By Joshua S. Tompkins and Paul Kunkel*

Although many cryptocurrencies have seen significant long-term price appreciation, the volatility of these assets, their boom and bust market cycles, and taxpayers' ability to specifically identify the units of cryptocurrency sold could result in some cryptocurrency investors realizing significant tax losses upon sale. In this article, Joshua S. Tompkins and Paul Kunkel consider whether the wash sale rules place limits on the deductibility of cryptocurrency losses and, for a variety of reasons, conclude that cryptocurrencies are most likely outside the scope of the wash sales rules as they currently stand today.

Introduction

Although certain cryptocurrencies have experienced tremendous long-term appreciation, the cryptocurrency market in general presents significant risk of loss, even for savvy investors. This risk is evidenced by the fact that the success of cryptocurrencies as an asset class has been concentrated in a small number of currencies.[1] Cryptocurrencies are also frequently characterized by significant short-term volatility and a boom and bust market cycle that makes investment timing critical.[2] In addition to these economic factors, the government's endorsement of specific identification lot relief methodologies for cryptocurrencies has increased the chances that well-advised taxpayers will realize tax losses when they sell.[3] Lastly, we note that recent guidance has indicated that exchanges of several major cryptocurrencies do not qualify for the pre-2018 like-kind-exchange exception to gain or loss recognition.[4]

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Taxpayers with significant cryptocurrency losses often wonder if there are any limitations placed on their ability to use the losses. In particular, taxpayers who are experienced with stock and securities investments often wonder if their cryptocurrency losses could be disallowed by the so-called "wash sale rules."[5]

The wash sale rules of Code Sec. 1091 only apply to transactions involving "stock or securities." There is a strong argument that cryptocurrencies are not stock or securities for purposes of Code Sec. 1091.

The wash sale rules were originally enacted in 1921 to prevent taxpayers from claiming tax losses while maintaining essentially the same economic position through the use of "wash sale transactions."[6] The abuse the wash sale rules were intended to address is illustrated by the following example:

> On December 31, 2020, Taxpayer holds 1,000 shares of Company A. Taxpayer purchased the shares of Company A for $100/sh, but the shares of Company A are now worth only $25/sh. Taxpayer would like to harvest this built-in loss for tax purposes but would also like to retain exposure to Company A.
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> Taxpayer sells all 1,000 shares on December 31, 2020 for $25/sh and realizes a $75,000 loss ($100,000 basis – $25,000 amount realized). On January 1, 2021, Taxpayer purchases 1,000 shares of Company A stock for $25/sh.
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> If the wash sales rules did not exist (or did not apply), Taxpayer would recognize his $75,000 realized loss and would have a $25,000 basis and new holding period in the Company A shares acquired on January 1, 2021. Thus, notwithstanding the fact that there was no meaningful change in his economic position, Taxpayer would have accomplished his goal of generating a tax loss.

The wash sale rules operate by disallowing a loss on the sale of a stock or security if the taxpayer acquires substantially identical stock or securities, or enters into a contract or option to acquire substantially identical stock or securities, within the 61-day period straddling the sale date (*i.e.*, the period starting 30 days before the sale date and ending 30 days after the sale date).[7] The disallowed loss is preserved through the application of special basis and holding period rules that tack the basis and holding period of the stock or security that was sold to the replacement stock or security.[8] Importantly, Code Sec. 1091 is a mechanical ruleset—no abusive intent is required for its application and normal investment activity frequently runs afoul of the wash sale limitations.[9]

Returning to the previous example, if the wash sale rules applied the result of the transaction would be:

> Taxpayer's $75,000 realized loss is disallowed.[10] Taxpayer's replacement share basis is $100,000 (initial basis of $100,000 + $25,000 acquisition cost for replacement shares – $25,000 sale price).[11] The holding period of the original shares is added to that of the replacement shares.[12]

Contrary to the apparent simplicity of the wash sale rules, their application in many contexts is fraught with complexity and uncertainty.[13] One such area of uncertainty is their scope—the wash sale rules are expressly limited to transactions involving stock or securities but there is no definition of these terms in the statute or the regulations.[14] While the meaning of the term "stock" is commonly understood to mean an equity interest in an entity classified as a corporation for federal income tax purposes, the term "security" has been given a variety of meanings in different contexts and its meaning in the context of Code Sec. 1091 is not immediately apparent.[15] Although certain "tokenized" instruments that represent an ownership interest in a corporate venture or a specific debt instrument might respectively be treated for purposes of the wash sale rules as stock or a security, or a right to acquire stock or a security, unless otherwise indicated in this article the term cryptocurrency is not intended to refer to such instruments. Instead, the discussion in this article is intended to be understood as applying only to certain "exchangeable" cryptocurrencies such as bitcoin and ether as they exist in the market today.[16] In this article, we attempt to answer the question of whether cryptocurrencies are appropriately classified as securities for purposes of Code Sec. 1091 and, by extension, whether cryptocurrency losses are subject to limitation by the wash sale rules. In this regard, useful points of reference can be found

in previous guidance considering the application of the wash sale rules to foreign currency transactions, stock and securities derivatives, and commodities transactions. We consider each of these points of reference, in turn, below.

Foreign Currency

In Rev. Rul. 74-218,[17] the IRS concluded that foreign currencies are not "securities" for purposes of Code Sec. 1091.[18] In making this determination, the IRS referred to Code Sec. 1236(c), which defines the term "security" to mean "any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing." The IRS went on to state that "[c]urrency in its usual and ordinary acceptation means gold, silver, other metals or paper used as a circulating medium of exchange" before concluding that foreign currencies are not securities. While not explicitly stated, it appears that the IRS's conclusion resulted from the fact that the Code Sec. 1236(c) definition of a security did not overlap with the IRS's description of a currency.

Rev. Rul. 74-218 is significant for three reasons. First, taxpayers might be able to argue (in some cases) that their cryptocurrency is foreign currency and that Rev. Rul. 74-218 is directly applicable. Second, taxpayers might reason that, even if a particular cryptocurrency is not a foreign currency, it is economically similar to foreign currency and sound policy therefore warrants a similar tax treatment. Third, a taxpayer could take the position that the IRS's reference to Code Sec. 1236(c) implies that the term "security" for purposes of the wash sale rules should be defined by reference to the (quite narrow) Code Sec. 1236(c) definition, which on its face arguably does not include cryptocurrencies.

We turn first to the possibility of directly relying on Rev. Rul. 74-218. A fundamental barrier to this position is the IRS's conclusion in Notice 2014-21[19] that cryptocurrencies are not currencies for U.S. Federal income tax purposes.[20] However, Notice 2014-21 technically only applies to "virtual currencies" which are defined to exclude "a digital representation of the U.S. dollar or a foreign currency."[21] Therefore, treating foreign currency stablecoins (*e.g.*, EURS and EUR-L)[22] as foreign currency would not be inconsistent with Notice 2014-21. Also, the conclusion that cryptocurrencies are not foreign currencies appears to have been based on the fact that no cryptocurrency had legal tender status at the time Notice 2014-21 was issued.[23] Since that time, several cryptocurrencies have been issued by foreign jurisdictions' central banks with legal tender status.[24] More significantly, bitcoin—the leading cryptocurrency by market capitalization and liquidity—has been given legal tender status in El Salvador.[25] Thus, to the extent the IRS's position that cryptocurrencies are not currencies was based solely on a lack of legal tender status, the position may no longer be tenable, at least in some cases.

Taxpayers with significant cryptocurrency losses often wonder if there are any limitations placed on their ability to use the losses. In particular, taxpayers who are experienced with stock and securities investments often wonder if their cryptocurrency losses could be disallowed by the so-called "wash sale rules."

Putting aside direct reliance, a taxpayer might still argue that the ruling provides a persuasive analogy or that sound tax policy demands a similar characterization, given the similarities between foreign currencies and cryptocurrencies. As evidence in favor of this position, bitcoin and many other cryptocurrencies were originally intended to function as a digital currency or medium of exchange, store of value, and unit of account (*i.e.*, fulfill the fundamental functions of money as does a foreign currency). However, as evidence to the contrary it should be pointed out that although cryptocurrencies were originally *intended* to fulfill the functions of money, cryptocurrencies have (to date) functioned primarily as an investment asset. In addition, cryptocurrency prices are significantly more volatile than those of foreign currencies and cryptocurrency price changes are driven by factors that are fundamentally different from the factors that determine the rate of exchange between various currencies.[26] Thus, while helpful, the foreign currency analogy is far from perfect.

Finally, Rev. Rul. 74-218 is significant because of its reference to the Code Sec. 1236(c) definition of a security. The citation to Code Sec. 1236(c) arguably implies that the definition of a security should be consistent between Code Secs. 1091 and 1236(c). The definition of a security under Code Sec. 1236(c) is quite narrow and literally does not include cryptocurrencies, thus providing more weight for the position that cryptocurrencies are not securities for purposes of Code Sec. 1091.

Stock and Securities Derivatives

Our second point of reference is the treatment of derivative instruments that reference stock or securities. Under the current version of the statute, Code Sec. 1091(a) provides (in relevant part): "[f]or purposes of this section, the term 'stock or securities' shall, except as provided in regulations, include contracts or options to acquire or sell stock or securities." Code Sec. 1091(f) goes on to state: "[t]his section shall not fail to apply to a contract or option to acquire or sell stock or securities solely by reason of the fact that the contract or option settles in (or could be settled in) cash or property other than such stock or securities." Taken together, Code Secs. 1091(a) and (f) make it clear that a contract to acquire or sell stock and securities, such as a securities futures contract, is itself a security notwithstanding the fact that it may be (or is required to be) cash-settled. Based on this statutory text, derivatives that reference stock or securities are generally subject to the wash sale rules.[27]

However, the treatment of stock or securities derivatives under the wash sale rules was not always so clear. Prior to 1988, Code Sec. 1091(a) did not explicitly treat contracts or options to acquire or sell stock or securities as stock or securities.[28] The government nevertheless consistently took this position.[29] As explained in informal guidance, the government believed that if securities derivatives were not subject to the wash sale rules it would create an opportunity for tax avoidance (*i.e.*, taxpayers could avoid the wash sale rules by transacting in stock and securities derivatives rather than stock or securities directly). Because the wash sale rules were intended to prevent taxpayers from generating artificial stock or securities losses, the government believed that treating stock or securities derivatives as being subject to the wash sale rules was consistent with Congressional intent.[30]

The government's appeal in the foregoing authorities to legislative intent and the need to prevent abuse through the use of derivative instruments was rejected by the Tax Court in *Gantner*.[31] In that case, the Tax Court concluded that stock options were not securities. The Tax Court first applied general principles of statutory construction and determined that the term "security" did not encompass options.[32] The Tax Court then went on to consider the legislative history of the wash sale rules and concluded there was "no indication whatsoever that Congress intended the statutory wash sale provision to disallow losses sustained on the sales of options."[33] The Tax Court noted that there was very little trading in options when the predecessor to Code Sec. 1091 was enacted in 1921, which explained why Congress did not contemplate stock options being securities for purposes of Code Sec. 1091.[34] The Tax Court also felt that the subsequent development of options markets and the lack of Congressional action in response further underscored the fact that Congress never intended for options to be treated as securities for purposes of the wash sale rules.[35] Interestingly, the Tax Court's opinion makes reference to the fact that stock options were treated as securities under Federal securities law, but did not appear to consider this fact relevant to determining whether stock options were securities for purposes of the wash sale rules.[36] In response to the *Gantner* decision, Congress amended Code Sec. 1091(a) to ensure that options and contracts to acquire stock or securities were subject to the wash sale rules.[37]

As the most recent case to consider the meaning of the term "security" in the wash sale context, *Gantner* is arguably the leading precedent and a strong indicator of how courts would evaluate other financial instruments in the absence of clear statutory or regulatory guidance. The *Gantner* decision suggests that financial instruments that were not in existence when the wash sale rules were enacted should not be subject to the wash sale rules. Under this interpretation of the scope of the wash sale rules cryptocurrencies should not be treated as securities. The *Gantner* decision is also significant in that it appears to indicate that an instrument's securities law classification is not relevant to determining whether it is a security for purposes of the wash sale rules. This may be particularly relevant for cryptocurrencies that are (or eventually become) classified as securities under Federal securities law.[38]

The government's position on the treatment of stock or securities derivatives prior to 1988 is also important for purposes of interpreting the scope of the wash sale rules because it sheds some light on the weight that should be afforded to the other definitions of the term "security" throughout the Code.[39] For example, in GCM 38369[40] the government stated:

> [W]e do not believe that the ruling should rely on the definition of 'securities' in another code section. Section 1091 and the regulations thereunder do not define the term 'securities,' and there is no indication in the legislative history that any other definition of 'security' or 'securities' set forth in the Internal Revenue Code was specifically intended to apply for purposes of section 1091. Therefore, one must consider any general congressional intent that may be gleaned from the Code and section 1091.

Nevertheless, GCM 38369[41] went on to acknowledge that:

> As a matter of statutory interpretation, the fact that Congress expressly treats an item consistently throughout many sections of the Code may provide strong evidence that the item should be similarly treated for purposes of a section in which the item is not expressly addressed.

The argument that a uniform treatment of an instrument throughout the Code as a security or not a security provides evidence as to the treatment of the instrument under the wash sale rules also seems implicit in the *Gantner* decision.[42] Cryptocurrencies are not explicitly treated as securities under any provision of the Code. Thus, while perhaps not determinative, this fact may provide strong evidence that cryptocurrencies are not securities for purposes of the wash sale rules.

However, it appears that the government may have reconsidered this position in response to subsequent regulatory developments. Specifically, in GCM 39551[43] the government stated:

> [The position that the phrase stock or securities should be gleaned from original Congressional intent] has arguably been obsoleted by Temp. Reg. §1.1092(b)-5T(q) which defines "securities" for purposes of section 1092 by referencing to the definition of securities in section 1236(c). Section 1092 provides rules for accounting for gains and losses with respect to straddles. Those rules often must operate in tandem with the wash-sale rules. We believe that the definition of securities for section 1092 should be identical to the definition of securities in section 1091. Accordingly, we view Temp. Reg. §1.1092(b)-5T(g) as defining the term "securities" in section 1091 with reference to the definition of "securities" in section 1236(c).

Given that GCM 39551 is the most recent administrative guidance and is reconcilable with the government's litigating position in *Gantner* (*i.e.*, a stock option would be a security under Code Sec. 1236(c)), it seems reasonable to conclude that even if the narrow reading of *Gantner* were rejected by the IRS, the Service would not attempt to expand the definition of a security beyond the scope of Code Sec. 1236(c) (which does not include cryptocurrencies in its definition of a "security").[44]

Commodities Derivatives

Our final point of reference is the treatment of commodity futures contracts. The treatment of these instruments was first considered in *Trenton Cotton Oil Co.*[45] In that case, the Sixth Circuit concluded that cotton oil futures were securities for purposes of the wash sale rules based on the ordinary meaning and dictionary definition of the term "security." This decision is, however, best regarded as an aberration. Later decisions consistently disagreed with its conclusion and uniformly treated commodities futures contracts as non-securities (and therefore not subject to the wash sale rules).[46] The IRS has also concluded that commodities futures are not subject to the wash sale rules.[47]

GCM 38369,[48] which considered the treatment of Treasury bill futures, helpfully reconciles the treatment of commodity futures contracts (as non-securities) with the government's treatment of securities futures contracts (as securities), stating:

> In Rev. Rul. 71-568, 1978-2 C.B. 312, we said that a commodity future was not a 'security' for purposes of the wash sales provisions. This ruling, however, did not analyze a commodity future in an item which was itself a 'security'. Futures trading in commodities which are not 'securities' presents an opportunity for tax manipulation. These futures, however, cannot be used as a substitute for trading in a 'security'. Furthermore, prices of these futures are not directly related to the price of a 'security' as are stock options and futures in Treasury bills and GNMAs. Therefore, [Rev. Rul.] 71-568 can be distinguished from the fact pattern in the proposed ruling.

In other words, the government distinguished commodities futures from securities futures based on the nature of the referenced asset. In the case of securities

futures, the derivative instrument could be used to take a position in a stock or security and avoid the application of the wash sale rules. The IRS believed that this warranted treating securities futures as securities. By contrast, commodities futures do not enable a taxpayer to take a position in a stock or security, and therefore should not be subject to the wash sale rules, notwithstanding the fact that there are liquid commodities markets that present an opportunity for taxpayers to engage in the types of transactions targeted by the wash sale rules. As noted previously, the *Gantner* decision may indicate that the IRS's historic position with respect to securities futures may not have been sustainable in the absence of legislative action. However, the reconciliation of the commodities futures and securities futures guidance provided by GCM 38369[49] is still important because it makes clear that (1) commodities are not securities and (2) the opportunity for tax manipulation is not relevant to determining whether a particular instrument is a security.

The foregoing implies that if cryptocurrencies are commodities, they should not be considered securities for purposes of Code Sec. 1091. Although the instruments refenced by the futures contracts in the authorities described above were tangible commodities, they are not as dissimilar from cryptocurrencies as they would immediately appear—in many cases, cryptocurrencies serve a utility function or serve as an input in another process. For example, ether is used to purchase the "gas" used to run smart contracts on the Ethereum network. Cryptocurrencies also appear to fit within the dictionary definition of a commodity, which includes "a mass-produced unspecialized product" and "something useful or valued."[50] In addition, the IRS looked to the agency responsible for regulating U.S. commodity exchanges as being the authority for purposes of defining the ordinary meaning of the term "commodity" in other contexts.[51] The CFTC has classified cryptocurrencies as commodities for regulatory purposes and this may suggest they should be treated as commodities for purposes of the wash sale rules.[52]

The second important takeaway from the guidance described above is that the opportunity for tax manipulation does not control whether an instrument is subject to the wash sale rules. Clearly, trading in certain cryptocurrencies does present an opportunity for tax manipulation through the use of wash sale strategies because there is a liquid market for fungible instruments that can be used to generate wash sale transactions. Nevertheless, this should not affect whether the wash sale rules apply, similar to how the wash sale rules do not apply to commodities generally.

Conclusion

The wash sale rules of Code Sec. 1091 only apply to transactions involving "stock or securities." There is a strong argument that cryptocurrencies are not stock or securities for purposes of Code Sec. 1091. This position is based on the following:

- No provision of the Code or Regulations treats cryptocurrencies as securities and the IRS has stated that "[a]s a matter of statutory interpretation, the fact that Congress expressly treats an item consistently throughout many sections of the Code may provide strong evidence that the item should be similarly treated for purposes of a section in which the item is not expressly addressed." Thus, because cryptocurrencies have consistently *not* been treated as securities, they arguably should not be treated as securities for purposes of the wash sale rules.
- Formal and informal IRS guidance suggests that the definition of a security for purposes of the wash sale rules may be linked to the Code Sec. 1236(c) definition of a security. This definition is quite narrow and does not include cryptocurrencies.
- The IRS has ruled that foreign currencies are not securities and at least one cryptocurrency (bitcoin) arguably now has the status of a foreign currency. Even in cases where the cryptocurrency in question is not a currency, the cryptocurrency might have functional similarities to foreign currencies that might suggest a similar treatment under the wash sale rules.
- Cryptocurrencies are economically similar to commodities and have been classified as commodities by the CFTC. Commodities are not securities for purposes of the wash sale rules.
- *Gantner* is the most recent case that considered the meaning of the term "securities" in the wash sale context. In this case, the court narrowly interpreted the term "securities" to include only instruments that Congress had knowledge of when first enacting the statute. This would not include cryptocurrencies. In addition, when Congress is aware of a new financial instrument and wants that instrument to be subject to a particular Code provision, Congress knows how to amend or add

to the Code to make this clear.[53] Courts appear reluctant to adopt an expanded interpretation of Code Sec. 1091 in an attempt to fill gaps in its scope that are more appropriately addressed through Congressional action.

- Although some cryptocurrencies may be characterized as securities by the SEC, no IRS guidance or court decision has interpreted the term "security" for purposes of the wash sale rules by reference to the instrument's regulatory classification. In fact, in *Gantner*, the Tax Court did not appear to believe the securities law classification of an instrument was relevant to its characterization for purposes of the wash sale rules.
- The IRS has indicated that the potential for tax manipulation is not controlling for purposes of determining whether an instrument is a security. Instead, the critical factor is the ability to use the instrument to circumvent the wash sales rules as they would otherwise apply to stock or securities. As a result, the government has only treated instruments other than stock or debt as securities in cases where the instrument was a derivative that referenced stock or debt. Cryptocurrencies do not reference stock or debt and should therefore not be treated as securities.

We close with a word of caution. The wash sale rules are not the government's only weapon against attempts to generate noneconomic losses. Depending on the circumstances of a particular transaction that appears to result in a loss, the loss may also be disregarded if the transaction does not result in a "bona fide" loss, lacks economic substance, or is a sham.[54] However, if the wash sales rules do not apply to cryptocurrencies that would remove a significant trap for the unwary and should be welcomed by taxpayers.

ENDNOTES

* Joshua Tompkins is also the Co-Editor-in-Chief of the JOURNAL OF TAXATION OF FINANCIAL PRODUCTS. The authors would like to thank Sam Chen for his thoughtful review of an earlier draft of this article.

1 In addition to the relatively concentrated price appreciation there are a number of so-called "dead coins" (cryptocurrencies that have failed). According to Coinopsy, there are 2,078 dead coins at the time of writing. *www.coinopsy.com/dead-coins/*. This represents about one-fifth of the cryptocurrencies that have existed.

2 Bitcoin, for example, has seen several periods of extreme price appreciation followed by sharp contractions. Most recently, the price of bitcoin rose from roughly $10,000/BTC in October 2020 to roughly $65,000/BTC in April 2021. Prices have since declined to roughly $40,000/BTC at the time of writing.

3 *See* IRS, *Frequently Asked Questions on Virtual Currency Transactions*, Q/A 39-40, available at *www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions*. *See also P.J. Perlin*, 86 TC 388, Dec. 42,932 (1986) (allowing specific identification for commodity sales); Reg. §1.1012-1(c) (setting forth specific identification rules for stock and securities sales).

4 *See* ILM 202124008 (2021).

5 Beyond the wash sale rules that are the subject of this article, there are frequently other limitations on the deduction of cryptocurrency losses. For example, cryptocurrencies losses are generally capital losses and subject to the overall capital loss limitations. *See generally* Code Sec. 1211. Losses in actively traded cryptocurrencies may also be deferred by the staddle rules of Code Sec. 1092. A detailed discussion of these rules and the other potential limitations on the deduction of cryptocurrency losses are outside the scope of this article.

6 HR Rep. No. 350, 67th Cong., 1st Sess. 11 (1921); S. Rep. No. 275, 67th Cong., 1st Sess. 14 (1921). *See also* GCM 39551 (1986); GCM 38369 (1980). The wash sale rules were enacted in response to reports that taxpayers were selling securities at a loss in the morning and repurchasing the same securities that afternoon. *See* Hearings on HR 8245, Committee on Finance, 67th Cong., 1st Sess. 51–52, 235–236 (1921).

7 Code Sec. 1091(a); Reg. §1.1091-1(a).

8 Code Sec. 1091(d); Reg. §1.1091-2 and Code Sec. 1223(3); Reg. §1.1223-1(d). Because the basis of the replacement stock or security is increased, the wash sale rules generally result in a deferral of the loss, rather than a permanent disallowance. There can, however, be situations where the disallowance is permanent (*e.g.*, if the taxpayer dies and the basis of the replacement stock is security is adjusted to fair market value).

9 There are, however, certain exceptions for losses sustained in the ordinary course of a trade or business by a taxpayer that is a dealer in stock or securities. *See* Code Sec. 1091(a); Reg. §1.1091-1(a).

10 Code Sec. 1091(a); Reg. §1.1091-1(a).

11 Code Sec. 1091(d); Reg. §1.1091-2.

12 Code Sec. 1223(3); Reg. §1.1223-1(d). Although this example is illustrative of the general mechanics of the wash sale rules, real-world wash sales tend to introduce additional wrinkles. For example, if there is a delay between the sale and purchase of a security (or *vice versa*) the holding period of the replacement stock or security may be longer or shorter than it would have been had the original instrument continued to be held. Also, there are frequently differences in the sales price and acquisition price that must be accounted for in the basis of the replacement shares (*i.e.*, the replacement shares will frequently have a basis that is different than the original shares).

13 Many of these complexities have been discussed at length by other authors. *See, e.g.*, Erika Nijenhuis, *Wash Sales Then and Now*, J. TAX'N FIN.

PRODS., 2003; David Schizer, *Scrubbing the Wash Sale Rules*, J. TAX'N FIN. PRODS., 2003; L. Farr and M.S. Farber, *Dirty Linen: Airing Out the Wash Sale Rules,* J. TAX'N FIN. PRODS., 2002; J. Krane, *Losses from Wash Sales of Stock or Securities*, 4 J. CORP. TAX 226 (1978).

[14] *See* Code Sec. 1091(a); Reg. §1.1091-1(a). Courts have strictly enforced this limitation. *See F.R. Horne*, 5 TC 250, Dec. 14,610 (1945) (loss on the sale of a membership on commodity exchange not subject to the wash sale rules because the membership interest was not a stock or security).

[15] *See, e.g.*, Code Sec. 165(g)(2) (defining the term "security" to mean a share of stock in a corporation; a right to subscribe for, or to receive, a share of stock in a corporation; or a bond, debenture, note, or certificate or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form); Code Sec. 402(e)(4)(E) (defining the term "securities" to mean only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form); Code Sec. 1236(c) (defining the term "security" to mean any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing); Code Sec. 6323(h)(4) (defining the term "security" to mean any bond, debenture, note or certificate or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money). *See also* Keyes, FEDERAL TAXATION OF FINANCIAL INSTRUMENTS & TRANSACTIONS, 16.02[2][a] ("The term 'securities' has been defined in a number of other Code sections, although the utility of these provisions in defining this term for Section 1091 purposes is limited, given the inconsistent and conflicting definitions contained therein.").

[16] We also caution readers that the cryptocurrency space continues to evolve and there may be new instruments created in the future (or existing instruments which the authors are not personally familiar with) that could warrant a different tax treatment than is discussed in this article. A final note on terminology: the IRS uses the term "cryptocurrency" to refer to "a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain" and has described "virtual currency" as "a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value other than a representation of the United States dollar or a foreign currency." Notice 2014-21, IRB 2014-16, 938; Rev. Rul. 2019-24, IRB 2019-44, 1004. In this article we use the term cryptocurrency as it is used in the popular press. This includes the types of assets encompassed within the IRS definition as well as some assets that arguably are not (*e.g.*, U.S. dollar or foreign currency backed stablecoins).

[17] Rev. Rul. 74-218, 1974-1 CB 202.

[18] The government had previously concluded in I.T. 1552, II-1 CB 96 (1923) that "Francs and other foreign moneys are not considered securities within the meaning of [the wash sale rules]" but did not elaborate on the basis for this conclusion.

[19] Notice 2014-21, IRB 2014-16, 938.

[20] *Id.*, at Q&A 2. *See also* Rev. Rul. 2019-24, IRB 2019-44, 1004.

[21] IRS, *Frequently Asked Questions on Virtual Currency Transactions*, Q/A 1, available at *www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions*.

[22] More information on EUR-L is available at *www.lugh.io/*.

[23] *See* Notice 2014-21, IRB 2014-16, 938 ("Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like 'real' currency—*i.e.*, the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance—*but it does not have legal tender status in any jurisdiction*.") (emphasis added). The definition of "real" currency in Notice 2014-21 appears to align with the Financial Crimes Enforcement Network definition of currency. *See* 31 CFR §1010.100(m). *See also* Rev. Rul. 2019-24, IRB 2019-44, 1004 (cross-referencing the 31 CFR §1010.100(m) definition of currency). According to FinCEN, virtual currency does not meet the definition of currency in its regulations because it "does not have all the attributes of real currency … [i]n particular … [it] does not have legal tender status in any jurisdiction." Financial Crimes Enforcement Network, *Guidance on the Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FIN-2013-G001 (Mar. 18, 2013).

[24] For further discussion of central bank cryptocurrencies and their tax classification, *see* Ted R. Stotzer, *Are Central Bank Cryptocurrencies Currency for U.S. Tax Purposes?*, 165 TAX NOTES FEDERAL 223 (Oct. 14, 2019).

[25] *See* Sarah Paez, *El Salvador Makes Bitcoin Legal Tender*, 171 TAX NOTES FEDERAL 1830 (June 14, 2021); Sarah Paez, *El Salvador's Adoption of Bitcoin Could Affect U.S. Tax Policy*, 2021 TAX NOTES TODAY INT'L 110–118 (June 9, 2021).

[26] Currency exchange rates are generally influenced by interest rate changes, unemployment rates, inflation reports, gross domestic product numbers, manufacturing data, and commodity prices. On the other hand, the price of cryptocurrencies appears to be influenced by memes, tweets, and government decrees as well as more fundamental factors such as the supply of the cryptocurrency and its utility.

[27] However, it is not entirely clear that *all* derivatives that reference stock or securities are subject to the wash sale rules. *See, e.g.,* Lucy Farr and Michael Farber, *Dirty Linen: Airing Out the Wash Sale Rules,* J. TAX'N FIN. PRODS., July 1, 2002 (indicating that there is "support for the notion that equity swaps are not securities for wash sale purposes").

[28] The expansion of the statute to cover options and contracts to acquire securities was made in response to the *Gantner* decision discussed *infra. See* P.L. 100-647, §5075(a). Code Sec. 1091(f) was later added by P.L. 106-554, §401(d).

[29] *See* GCM 37332 (1977) ("when issued" securities are securities); GCM 38369 (1980) (treasury bill futures are securities); GCM 38285 (1980) (exchange traded options are securities); GCM 39551 (1986) (GNMA certificates are securities).

[30] *See* GCM 38285 (1980) ("We further believe that concluding that call options are within the scope of section 1091 is consistent with the legislative intent underlying that section. The recognized purpose of the section 1091 wash sale provision is to prevent tax manipulation by a taxpayer who attempts to recognize a loss while maintaining an identical or nearly identical investment position. As we noted in G.C.M. 37679, the manner in which call options are traded on an options exchange is similar to the manner in which stocks are traded on a stock exchange. Moreover, the price of a call option can generally be expected to fluctuate in a manner that reflects fluctuations in the price of the underlying stock. In other words, trading in options is another way to speculate on fluctuations in the price of the stock itself, and options constitute a substitute means of dealing with the underlying stock. Therefore the opportunities for a trader in call options to recognize 'artificial' losses on dealings in those options are comparable to the opportunities afforded traders in stocks with respect to similar losses on stock transactions, and we believe that call options, like stock, should be within the scope of the wash sale provisions. We therefore conclude that call options are 'stock or securities' for the purposes of section 1091.") (internal citations omitted); GCM 38369 (1980) ("We believe … that treating Treasury bill futures as 'securities' is consistent with Congressional intent … Treasury bill futures,

like options, allow an investor to invest in a potentially lucrative market without investing large amounts of capital. These investors could avoid the purpose of the wash sales provisions if they can recognized [*sic*] a loss on their 'wash sales.'").

[31] *Gantner*, 91 TC 47 (1988).

[32] The wash sale rules require both a sale and an acquisition or reacquisition event. The acquisition or reacquisition event requirement can be satisfied by acquiring substantially identical stock or securities to the stock or securities sold *or by entering into a contract or option to acquire such securities*. The Tax Court interpreted this to mean that a contract or option to acquire stock or securities is not the same as an acquisition of stock or securities. *Gantner*, at 721.

[33] *Gantner*, at 723.

[34] *Gantner*, at 724.

[35] *Gantner*, at 724.

[36] *Gantner,* at footnote 6.

[37] P.L. 100-647, §5075(a).

[38] SEC officials have publicly stated that bitcoin and ether are not securities. Available at *www.cnbc.com/2018/06/14/bitcoin-and-ethereum-are-not-securities-but-some-cryptocurrencies-may-be-sec-official-says.html*. However, the classification of many other instruments is still unclear. For example, at the time of writing, Ripple Labs and the SEC are engaged in ongoing litigation over the classification of XRP under Federal securities law. Available at *www.jdsupra.com/legalnews/sec-vs-ripple-could-make-waves-in-9047056/*.

[39] *See, supra* note 15.

[40] GCM 38369 (1980).

[41] GCM 38369 (1980).

[42] *Gantner*, at 720 ("Other sections of the Code contain the term 'stock or securities,' but stock options are not treated *uniformly* in all those sections .... We therefore shall focus on the terms of section 1091 itself to ascertain whether a stock option is a security.") (emphasis added).

[43] GCM 39551 (1986).

[44] This view is also supported by Rev. Rul. 74-218, which also references Code Sec. 1236(c).

[45] *Trenton Cotton Oil Co.*, CA-6, 45-1 USTC ¶9163, 147 F2d 33.

[46] *See Corn Products Refining Co.*, CA-2, 54-2 USTC ¶66,082, 215 F2d 513; *Sicanoff Vegetable Oil Co.*, CA-7, 27 TC 1056, Dec. 22,310 (1957), *rev'd* on *other grounds* 251 F2d 764 (1958).

[47] GCM 34630 (1971); Rev. Rul. 71-568, 1971-2 CB 312.

[48] GCM 38369 (1980).

[49] GCM 38369 (1980).

[50] Available at *www.merriam-webster.com/dictionary/commodity*. *See also Xianli Zhang*, FC, 640 F3d 1358, 1364 (2011) ("Dictionary definitions can elucidate the ordinary meaning of statutory terms.").

[51] Rev. Rul. 73-158, 1973-1 CB 337.

[52] *See Testimony of CFTC Chairman Timothy Massad before the U.S. Senate Committee on Agriculture, Nutrition & Forestry*, CFTC December 10, 2014, available at *www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-6*. *See also CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets*, CFTC, January 4, 2018, available at *www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/backgrounder_virtualcurrency01.pdf*; *Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions*, In the Matter of Coinflip, Inc. d/b/a Derivabit, and Francisco Riordan, September 17, 2015, available at *www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf* ("Section 1a(9) of the Act defines 'commodity' to include, among other things, 'all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.' 7 U.S.C. §1a(9). The definition of a 'commodity' is broad. *See, e.g.,* Board of Trade of City of Chicago v. SEC, 677 F. 2d 1137, 1142 (7th Cir. 1982). Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities."). But *see Gantner*, at footnote 6 (discounting the securities law classification of stock options).

[53] *See, e.g.,* the 1988 amendment to Code Sec. 1091(a); the 2000 addition of Code Sec. 1091(f); changes over time to Code Sec. 1256(b)(1); the 2010 addition of Code Sec. 1256(b)(2)(B); the 1999 addition of Code Sec. 1221(a)(6).

[54] *See, e.g., Horne*, 5 TC 250, Dec. 14,610 (1945) (the court determined that the wash sale rules did not apply, nevertheless denied a deduction for the purported loss on the basis that it was not "real"); Rev. Rul. 77-185, 1977-1 CB 48 (loss denied because there was no real change of position in a true economic sense).