Some virtual currency units and positions are treated as securities by the SEC and US courts. The IRS, however, has told taxpayers that it views convertible virtual currency as property, not foreign currency, for federal tax purposes. Lacking clear guidance from the IRS or the Department of the Treasury, this article addresses issues that may help determine whether Internal Revenue Code provisions that apply to securities might also apply to transactions involving virtual currencies and positions.

IN DEPTH

Some virtual currency units and positions are treated as securities for US regulatory purposes by both the Securities and Exchange Commission (SEC) and the courts. This raises the question of whether the Internal Revenue Service (IRS) might follow the SEC’s lead and treat certain virtual currency units or positions as securities for tax purposes and, if so, on what basis? The answer to this question is important because treating a virtual currency position as a security for tax purposes could significantly affect its tax treatment.
At the date of this article, we have no guidance from the Department of the Treasury or the IRS as to whether they treat any virtual currency positions as securities. (For a discussion of whether virtual currency can be treated as commodities, see McDermott’s Memorandum, “Can a Virtual Currency Position be Treated as a Commodity for Tax Purposes?”). IRS Notice 2014-21 (2014-16 I.R.B. 938) and the 2019 Frequently Asked Questions (FAQs) tell us that the IRS views convertible virtual currency as property, not foreign currency, for federal tax purposes (Notice 2014-21, Q&As 1 and 2; 2019 FAQs). The IRS has been silent, however, as to whether virtual currency units or positions might be taxed as securities. This article examines some representative places in the Internal Revenue Code where “securities” are specifically addressed and considers possible application to virtual currency.

Stock or Securities

The phrase “stock or securities” appears in various Code provisions. In some places it appears without a definition or explanation of its intended meaning, while in other places it is defined for application to a specific Code provision. In all of the Code sections addressing “stock or securities,” the term stock is always limited to shares of stock in a corporation. As a result, it is clear that virtual currency units and positions are not stock for tax purposes.

But what about virtual currency falling within the term securities? When “securities” is used in the Code, it typically refers to debt securities, such as notes, bonds, debentures and other evidences of indebtedness. There are, however, some Code provisions that define the term securities more broadly. For example, a securities dealer can hold securities in her investment account. For these purposes, security is defined to include notes, bonds, debentures, evidences of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing products (I.R.C. § 1236(c)). Thus, a security dealer’s investment account can include not just stock and debt securities but also options, warrants and stock rights. Even under this expanded definition, however, it does not appear as if the term securities is broad enough to include virtual currency units or positions.

In considering how the term securities might be defined, it is particularly useful to consider the tax wash sales rule. The wash sales rule disallows certain losses from the sale or other disposition of “stock or securities” without providing any further elaboration of that phrase. In a Tax Court case, Gantner v. Commissioner (91 T.C. 713 (1988), later proceeding Gantner v. Commissioner, 92 T.C. 192 (1989), aff’d, 905 F.2d 241 (8th Cir. 1990), cert. denied, 498 U.S. 921 (1990)), the court found that stock options were not securities for purposes of the wash sales rule. In Gantner, the taxpayer had purchased exchange-traded call options on stock, sold those options at a loss, and then bought identical stock options within the prohibited time period for deducting losses on stock or securities. (For a discussion of the wash sales rule, see McDermott’s article, “When Virtual Currency Positions are Subject to the Wash Sales Rule.” (to be published June 17)). The IRS denied the taxpayer’s deduction, asserting that the sale at a loss and the subsequent purchase were a wash sale (91 T.C. 713).

The Tax Court disagreed with the IRS, finding that an option to acquire stock was not
“stock or securities” and did not fall within the plain meaning of the wash sales rule (91 T.C. at 721). In reaching this conclusion, the Tax Court examined the legislative history of the wash sales rule to examine congressional intent when the wash sales rule was enacted in the 1920s. The Tax Court noted that Congress had never intended to treat stock options as securities subject to the wash sales rule (Id.); there had not been a significant stock options market when the wash sales rule was enacted (Id. at 722); and Congress could have—but had not—amended the wash sales rule to include stock options in the definition of securities after stock options started trading (Id. at 724).

After Gantner, Congress promptly amended the wash sales rule to expand its scope to include “contracts or options to acquire or sell stock or securities” (I.R.C. § 1091(a), as amended by Pub. L. No. 100-647, § 5075(a), 102 Stat. 3342 (1988) [hereinafter TMRA ‘88], for any sales after November 10, 1988, in tax years ending after such date). Interestingly, Congress did not attempt to define securities with this amendment and it did not attempt to include options in the definition of securities. The fact that Congress felt it was necessary to amend the wash sales rule to include options within the scope of the wash sales rule is particularly instructive in considering whether a virtual currency or a position in virtual currency could be treated as a security for tax purposes.

Virtual Currency

The key point to take away from the discussion in this article, the Gantner decision and the congressional response to Gantner, is the fact that virtual currency was never considered by Congress when it enacted any of the Code provisions that currently apply to stock or securities. This strongly suggests that virtual currency units and positions are not likely to be treated as securities for tax purposes. It does remain a possibility, however, because there are some situations in which virtual currency positions—such as certain initial coin offerings (ICOs) and certain tokens—are treated as securities under SEC rules and court decisions (see SEC, Report of Investigation Pursuant to §21(a) of the Securities Exchange Act of 1934; The DAO, Securities Act Release No. 81207 (July 25, 2017), at 3). As a result, taxpayers need to consider the possibility that if the SEC were to treat particular virtual currencies transactions as securities, the IRS might also seek to treat those transactions as securities for various Code provisions that apply to securities.

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Taxpayers should discuss their virtual currency positions with their tax advisors to determine whether the Code provisions that apply to securities might be applied to their transactions. Although most virtual currency positions are not likely to be treated as securities for tax purposes, taxpayers should be aware of the possibility.

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