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## BITCOIN: THE CONFLICTING CURRENCY

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### INTRODUCTION

Bitcoins are a new and successful form of virtual currency or digital money. A bitcoin is an electronic item of value that can be used as a medium for exchange of goods and services and even conversion to real currency backed by recognized national governments. Like all new conceptions that break traditional boundaries, bitcoins or virtual currencies are still misunderstood from a legal perspective. Currently, no federal legislation has been created with respect to virtual currencies, and regulatory bodies such as the Internal Revenue Service (“IRS”), the U.S. Department of Treasury and Financial Crime Enforcement Network (“FinCEN”), and the U.S. Securities and Exchange Commission (“SEC”) have all been left to interpret existing law against the new monetary medium. Meanwhile, federal courts have only occasionally ruled on the legal status of bitcoins themselves, but at all times found that the virtual currency should be treated as a form of online money. While the federal court rulings are still in infancy, they may pose complications for certain federal regulatory bodies that wish for the bitcoin currency to be legally treated as property such as the IRS.

## PROSPECTUS

This note will break down what bitcoins are and how the federal government is currently classifying and treating them, before moving towards analyzing how bitcoins will be classified in the future once full harmony is reached between all the branches of government. The note will: analyze the main federal court cases (there are only three); explain how the federal government has reached the classification of bitcoin as money before applying its significance to IRS, Treasury and SEC publications; and look at the inconsistent treatment of bitcoins throughout the government. The note will go on to analyze the IRS and other regulatory bodies and their treatment of bitcoins as either property or at least “not currency,” and whether or not it matters that the federal courts, and regulatory bodies are inconsistently treating bitcoins for criminal and tax purposes. Finally, the note will touch on the legislative opinion (or lack thereof) on bitcoins and how current laws are meant to apply to them.

Part I of this note will give the history and origin of bitcoins, and explain where the concept of virtual currency came from. Parts II and III will discuss the inner workings of the bitcoin system and how it survives as a viable currency without a third party facilitator to back its value. Part IV explains the current U.S. government treatment of bitcoins by breaking the topic down into subparts for each government branch: subpart A is the judicial branch, subpart B is the executive branch, subpart C is the legislative branch, and subpart D will showcase state sovereign bitcoin treatment. Part V and VI will analyze the current state of affairs and determine a likely path for the legal future of bitcoins and whether or not the different apparatus’s of the U.S. government have to be in harmony in their respective bitcoin treatment. Finally, the conclusion will consider all the relevant factors discussed within the note in determining the correct current legal standard for bitcoins.

BITCOINS AND THE AMERICAN DREAM

I. IN THE BEGINNING THERE WAS BITCOIN

Bitcoins are the first open source digital currency to operate over a peer to peer payment network.<sup>1</sup> Bitcoin is the world's first decentralized digital payment system.<sup>2</sup> It does not require a bank or a middleman.<sup>3</sup> Bitcoins have been described as "cash for the internet" by some of the software's core developers.<sup>4</sup>

Bitcoins stemmed from the idea of "crypto-currency" as coined by one Wei Dai in 1998.<sup>5</sup> The idea was a new form of currency that used encryption to control inflation and transactions, instead of a centralized authority.<sup>6</sup> The bitcoin concept itself and supporting software specifications were first published in 2009 by one Satoshi Nakamoto to a cryptography mailing list.<sup>7</sup> Nakamoto left bitcoin development in 2010, and details of his past and whether or not he was a real person or just a pseudonym have been speculative ever since.<sup>8</sup> However, the bitcoin concept continued to grow and has since been fostered by a group of "core developers."<sup>9</sup> Bitcoin itself is simply openly shared software that any developer could review or even make their own version of.<sup>10</sup>

Bitcoins are not technically controlled by anyone. While a group of core developers improve and manage the

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<sup>1</sup> Bitcoin Project, *Frequently Asked Questions*, <https://bitcoin.org/en/faq> (last visited Oct. 17, 2004).

<sup>2</sup> Jerry Brito & Andrea Castillo, *Bitcoin: A Primer for Policymakers*, Mercatus Center, George Mason University, 3 (2013), [http://mercatus.org/sites/default/files/Brito\\_BitcoinPrimer.pdf](http://mercatus.org/sites/default/files/Brito_BitcoinPrimer.pdf).

<sup>3</sup> *Id.*

<sup>4</sup> Bitcoin Project, *supra* note 1.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> Benjamin Wallace, *The Rise and Fall of Bitcoin*, *Wired* (Nov. 23, 2011), [http://www.wired.com/2011/11/mf\\_bitcoin/all/](http://www.wired.com/2011/11/mf_bitcoin/all/).

<sup>9</sup> Bitcoin Project, *supra* note 1.

<sup>10</sup> *Id.*

software, the core developers have no power to force bitcoin users to use a completely changed bitcoin software.<sup>11</sup> Bitcoins will only work when there is a consensus of users using the same software version, and therefore all users and developers have a strong motivation to keep the bitcoin system constant.<sup>12</sup>

## II. BITCOIN 101

For the average bitcoin user, the digital currency is simply a computer application that provides a digital “wallet” and allows for bitcoins (the form and denomination of the digital currency) to be sent and received in an effort to create consideration.<sup>13</sup> The value of bitcoins are not derived from any precious metal or government, but only what people believe they are worth.<sup>14</sup> However, what makes bitcoins special is that they created a solution to a fundamental problem that plagued all past incarnations of virtual currency.

The issue with past decentralized digital currency is that it lacked a trusted third party intermediary.<sup>15</sup> For the majority of transactions over the internet, a service such as PayPal or Visa records the transaction and keeps a record or a “ledger” of the user’s account balance.<sup>16</sup> Without such third-parties to act as ledgers, decentralized digital currencies could easily fall prey to “double-spending”.<sup>17</sup> This means the digital currency could possibly be spent multiple times.<sup>18</sup> The double-spending problem arises from the format of digital currency: if the currency is truly just a digital computer file, what is to stop its circulators from simply copying the file and sending it to multiple destinations?

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Bitcoin Project, *supra* note 1.

<sup>14</sup> Brito & Castillo, *supra* note 2, at 4.

<sup>15</sup> *Id.* at 3.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

Bitcoins are the first format of digital currency to solve the problem of double spending.<sup>19</sup> Bitcoins accomplish this feat by creating a public ledger called the “block chain” that records every user’s transaction.<sup>20</sup> All new transactions are checked against the block chain to ensure that previous bitcoins are not being used again by the same user.<sup>21</sup> Each bitcoin transaction is verified by requiring the parties to “sign” their transaction with a key code.<sup>22</sup> Every signature includes two types of key codes: a public key and a private key.<sup>23</sup> The two types of keys are used in every signature help prevent fraud and double spending.<sup>24</sup>

Although each user has a public and private key to use as a signature for each transaction, the public keys are not linked to anyone’s identity.<sup>25</sup> This helps bitcoin transactions stay anonymous, but also raises concerns of criminal activity. However, the anonymity of bitcoins is only half-fold. Each bitcoin transaction and public key records the user’s IP address which can be tracked to them in case of illegal activity, but there is nothing to stop a user from using a proxy server for each transaction to hide their real IP address either.<sup>26</sup> In this regard, bitcoin transactions can be analogized to cash and a form of public receipt. Finally, it is speculated, as the bitcoin currency becomes more adopted, it will become more and more regulated in line with banking and financial regulations, and total anonymity will become much more difficult.<sup>27</sup>

### III. DO STORKS DELIVER BITCOINS?

Since there is no central bank or authority in control of the bitcoin supply, the bitcoin software

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<sup>19</sup>*Id.* at 4.

<sup>20</sup> Bitcoin Project, *supra* note 1.

<sup>21</sup> Brito & Castillo, *supra* note 2, at 4.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 8.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 9.

application creates new bitcoins based off of users who voluntarily verify the “block chain” transactions as discussed earlier.<sup>28</sup> These users that verify the block chain are called “miners” and in exchange for their work they receive new bitcoins or an actual transaction fee.<sup>29</sup>

However, the bitcoin mining process is more complicated than just verifying a signature; transactions can only be verified by using computing power to solve complex math problems.<sup>30</sup> The equations are designed to become more complicated as more bitcoins are mined, and as more bitcoins are mined, transaction fees will replace bitcoins as compensation for mining.<sup>31</sup> The bitcoin system is designed like a traditional money system based off precious metals or items of value because the number of bitcoins that can ever be mined has been limited to 21 million as part of the software’s parameters.<sup>32</sup> This is in opposition to most government monetary structures that operate under fiat conditions where the amount of money in circulation can be continuously created. However, similar to the fiat system is the fact that bitcoin value is only as much as the public ascribes to it.

#### IV. DOES UNCLE SAM KNOW ABOUT THIS?

Unfortunately, there is a dark side to bitcoin use, and things are not as homologous as they could be within the United States Government branches. For the purpose of judicial proceedings, the U.S. District Courts and executive regulatory bodies are split on whether bitcoins qualify as money or property.

##### A. TELL IT TO THE JUDGE

On August 6, 2013, the Eastern District of Texas, in *SEC v. Shavers*, decided whether or not Investments in a Bitcoin Trust were considered securities under federal

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<sup>28</sup> *Id.* at 5.

<sup>29</sup> Bitcoin Project, *supra* note 1.

<sup>30</sup> Brito & Castillo, *supra* note 2, at 7.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

securities law.<sup>33</sup> It was the first bitcoin definition case heard around the world.

The Defendant was charged by the SEC with operating a Ponzi scheme, where investors invested into his Bitcoin Trust.<sup>34</sup> The Defendant argued that the Bitcoin Trust investments were not securities by simple virtue, that bitcoins are not money.<sup>35</sup> The SEC countered that investments in bitcoins and the Bitcoin Trust are investment contracts, and therefore, qualify as securities.<sup>36</sup>

A “security” is “any note, stock, treasury stock, security future, security-based swap, bond... [or] **investment contract**” (**Emphasis added**).<sup>37</sup> In pertinent part, an “investment contract” is any contract, scheme, or transaction involving an investment of money.<sup>38</sup>

The Court held that the Bitcoin Trust investment did amount to an investment of money.<sup>39</sup> However, even more importantly, the Court specifically identified bitcoins as a “currency or form of money.”<sup>40</sup> In fashioning its determination of whether or not the Bitcoin Trust investments constituted an investment of money, the Court first notes that “it is clear that bitcoin[s] can be used as money.”<sup>41</sup> Bitcoins can be “used to purchase goods or services, and as [the Defendant] stated, used to pay for living expenses.”<sup>42</sup> While the Court did note that bitcoins are limited to “those places that accept it as currency,” the Court also reasoned that this was not a hindrance because bitcoins can also be exchanged for many strong currencies such as the U.S. Dollar, Euro, and Yen. For these reasons,

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<sup>33</sup> *SEC v. Shavers*, No. 4:13-CV-416, 2013 U.S. Dist. LEXIS 110018, at \*3-4 (E.D. TX. Aug. 6, 2013).

<sup>34</sup> *Id.* at 2-3.

<sup>35</sup> *Id.* at 4.

<sup>36</sup> *Id.*

<sup>37</sup> 15 U.S.C.S. § 77b (LexisNexis 2016).

<sup>38</sup> *Shavers*, 2013 U.S. Dist. LEXIS 110018, at \*4 (citing *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946)).

<sup>39</sup> *Id.* at 5.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 4.

<sup>42</sup> *Id.* at 4-5.

the Court felt that bitcoins do qualify as a “form of money.”<sup>43</sup>

United States Magistrate Judge Amos Mazzant wrote not only the first opinion by a United States District Court on the issue of whether bitcoins constitute money, but he likely also wrote the strongest opinion to this day in terms of diction on the issue. Judge Mazzant comes right out and calls bitcoins a “currency or a form of money”<sup>44</sup> It is important to note that this opinion was written before an applicable IRS Notice which states bitcoins should be treated as property (at least for tax purpose, but including tax crimes).<sup>45</sup> However, the ruling was decided after the U.S. Department of Treasury, Financial Crimes Enforcement Network (“FinCEN”) issued an official Guidance on March 18, 2013, that stated bitcoins are not a form of currency or legal tender.<sup>46</sup> It’s unclear whether the Defendant in *Shavers* relied upon the FinCEN Guidance or his own logic for his argument. Regardless, Judge Amos makes no reference to persuasive or binding authority on either side of the issue.

What stands out about the *Shavers* ruling is the fact that it rests on practicality and common knowledge. Since there is limited federal precedent on the issue, instead of looking to outside sources and persuasive authority, Judge Mazzant simply states the attributes of bitcoins in a very *Res Ipsa Loquiter* fashion and comes to the conclusion that bitcoins are indeed money. In later federal cases, a common theme will be using common sense and common definitions of money, while ignoring technical definitions of electronic software or property.

Summary judgment was ruled in favor of the SEC and against *Shavers* on September 18, 2014.<sup>47</sup> No appeal had been filed against the determination of bitcoins as

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<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at 5.

<sup>45</sup> Internal Revenue Service, *I.R.S. Notice* 2014-21, 2 (Mar. 25, 2014), <http://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

<sup>46</sup> *FinCEN Guid.* FIN-2013-G001, 1 (Mar. 18, 2013), [http://fincen.gov/statutes\\_regs/guidance/pdf/FIN-2013-G001.pdf](http://fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf).

<sup>47</sup> *SEC v. Shavers*, No. 4:13-CV-416, 2014 U.S. Dist. LEXIS 130781, at \*38. (E.D. Tex. Sep. 18, 2014).



money ruling, which was a central jurisdiction issue to the case, as of March 3, 2015.

On July 9, 2014, the Southern District of New York, in *United States v. Ulbricht*, involved a Defendant charged with money laundering conspiracies that involved the operation of a website known as the Silk Road, which acted as an online marketplace for illicit goods and services.<sup>48</sup>

The Defendant was charged under 18 U.S.C § 1956(h) with participation in a money laundering conspiracy.<sup>49</sup> The contested element of money laundering conspiracy by the Defendant involved:

“It was part and an object of the conspiracy that ... the defendant, and others ... knowing that the property involved in certain *financial transactions* represented proceeds of some form of unlawful activity, would and did conduct and attempt to conduct such *financial transactions*, which in fact involved the proceeds of specified unlawful activity[.]” (*emphasis added*).<sup>50</sup>

Under the above money laundering statute, a financial transaction is “the movement of funds by wire or other means, ... or involving one or more monetary instruments[.]”<sup>51</sup> The term “monetary instrument” includes: bank checks, personal checks, the currency or coin of a country, money orders, or negotiable instruments or investment securities.<sup>52</sup>

The Defendant challenged the money laundering charge by claiming it was impossible for him to launder money because bitcoins are not “monetary instruments” that can form the basis of financial transactions. The Defendant, for his defense, cleverly relied on a very recent IRS Notice that confirmed the IRS would treat virtual

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<sup>48</sup> *United States v. Ulbricht*, 2014 U.S. Dist. LEXIS 93093, at \*1-2. (S.D.N.Y. July 9, 2014).

<sup>49</sup> *Id.* at 66.

<sup>50</sup> *Id.* at 67.

<sup>51</sup> 18 U.S.C. § 1956(c)(4) (2016).

<sup>52</sup> 18 U.S.C. § 1956(c)(5) (2016).

currency as property and not currency for tax purposes.<sup>53</sup> The Defendant also referenced FinCEN's recent Guidance that declared virtual currencies are not "legal tender," nor do they have the attributes of real currency which need to be issued by a country.<sup>54</sup>

The Court disagreed, and found the Defendant's contention and cited support unpersuasive. The Court stated that "neither the IRS, nor FinCEN ha[ve] addressed the question of whether a 'financial transaction' can occur with bitcoins[,] nor do they have any power to amend and interpret the money laundering statute for the Courts."<sup>55</sup> The Court concluded that "financial transaction" is broadly defined, and it includes all movements of "funds" by any monetary instrument or other means.<sup>56</sup> The Court applied the ordinary meaning to the term "funds" because the definition was not included in the money laundering statute.<sup>57</sup> Citing to the dictionary definition, "funds" are defined as "money" and "money" is defined as "an object used to buy things."<sup>58</sup>

The Court held from these definitions that bitcoins are indeed encompassed under the term "financial transaction."<sup>59</sup> The District Court Judge was either very careful not to explicitly state that bitcoins are funds or money or simply pressed for time, but the deduction is self-evident by the Court's conclusion that bitcoins are encompassed under "financial transactions," which include all movement of funds.<sup>60</sup> The Court held that "[p]ut simply, 'funds' can be used to pay for things in the colloquial sense. Bitcoins can either be used directly to pay for certain things or can act as a medium of exchange [and]

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<sup>53</sup> See *Ullbright*, 2014 U.S. Dist. LEXIS 93093 at 69-70 (citing *I.R.S. Note*, 2014-21).

<sup>54</sup> *Id.* (citing *FinCEN Guid.* FIN-2013-G001).

<sup>55</sup> *Id.* at 69.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 69-70.

<sup>58</sup> *Id.* at 70 (citing *Cambridge Dictionaries Online*, <http://dictionary.cambridge.org/us/dictionary/american-english/funds?q=funds> (last visited July 3, 2014)).

<sup>59</sup> *Id.* at 71.

<sup>60</sup> *Id.*

... the value of bitcoins lie in their ability to pay for things[.]”<sup>61</sup>

The *Ulbirct* Case was the second in a line of three District Court cases that have shown resistance to any persuasive authority in regards to the monetary status of bitcoins, including the previous *SEC v. Shavers* case. Judge Forrest, of the Southern District of New York, at times even appeared hostile to the contention that bitcoins were anything but money. From an objective point of view, the interpretation the Court took towards bitcoin was very practical, opting for a common sense breakdown of *what bitcoins are meant to do*, while avoiding technical semantics of currency and bartering.

A little over a month later, on August 18, 2014, the Southern District of New York was faced again with the issue of whether or not bitcoins qualify as money.<sup>62</sup> This time with one District Court Judge Jed Rakoff presiding. The Defendant was charged with operating an unlicensed money transmitting business under 18 U.S.C. § 1960.<sup>63</sup>

18 U.S.C. § 1960 includes references to the words “money” and “funds.” Under Section 1960, “money transmitting” is the “transferring funds on behalf of the public by any and all means.”<sup>64</sup> The Defendant argued that bitcoins do not qualify as money under Section 1960, and used the FinCEN Guidance ruling that states bitcoins are not a currency.<sup>65</sup>

The Court disagreed, and like previous cases, looked to the plain meaning of the words “money” and “funds.”<sup>66</sup> In this case the court took the time to explain (via footnote) that words like “funds” or “money” deserve an ordinary dictionary definition, contrary to any Black Letter Law definition because the statute 1960 does not even “remotely” suggest that the words are legal “terms of art,” thus ordinary meanings are intended, although under

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<sup>61</sup> *Id.* at 70.

<sup>62</sup> *United States v. Faiella*, No. 14-cr-243, 2014 U.S. Dist. LEXIS 116114 (S.D.N.Y. Aug. 18, 2014).

<sup>63</sup> *Id.* at 2.

<sup>64</sup> 18 U.S.C. § 1960(b)(2).

<sup>65</sup> *Faiella*, 2014 U.S. Dist. LEXIS 116114 at 6.

<sup>66</sup> *Id.* at 2.

most Black Letter definitions, the result would be the same.<sup>67</sup> The court found that “money” in ordinary context means “something generally accepted as a medium of exchange, measure of value, or a means of payment.”<sup>68</sup> Prominently, an example of money includes “money of account” which is “a denominator of value or basis of exchange which is used in keeping accounts and for which there may or may not be an equivalent coin or denomination of paper money.”<sup>69</sup> “Funds” were also defined as “available money [or] an amount of something that is available for use: a supply of something.”<sup>70</sup>

The Court held that it was obvious bitcoins qualify as money or funds under their ordinary meanings.<sup>71</sup> Reasoning that “bitcoin[s] can be easily purchased in exchange for ordinary currency, acts as denominator of value, and is used to conduct financial transactions.”<sup>72</sup> For the first time, we see a Court cite to persuasive judicial authority too, quoting *SEC v. Shavers*, “[i]t is clear that bitcoin[s] can be used as money ... to purchase goods or services.”<sup>73</sup> The Court also found that Section 1960, although legislated in 1990, was written to combat “evolving threats” such as “nonbanking financial institutions” that “convert street currency into monetary instruments” for the purpose of drug sales.<sup>74</sup>

Judge Rakoff in the Southern District of New York writes a very broad opinion, but leaves no question as to what bitcoins are; they are money. In a way, his opinion seems much more well-rounded than his counterpart

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<sup>67</sup> *Id.*

<sup>68</sup> *Id.* (quoting *Merriam-Webster Online*, <http://www.merriam-webster.com/dictionary/money> (last visited Aug. 18, 2014)).

<sup>69</sup> *Id.* at 2 (quoting *Merriam-Webster Online*, <http://www.merriam-webster.com/dictionary/money> (last visited Aug. 18, 2014)).

<sup>70</sup> *Id.* at 2-3 (quoting *Merriam-Webster Online*, <http://www.merriam-webster.com/dictionary/money> (last visited Aug. 18, 2014)).

<sup>71</sup> *Id.* at 3.

<sup>72</sup> *Id.*

<sup>73</sup> *SEC v. Shavers*, No. 4:13-CV-416, 2014 U.S. Dist. LEXIS 130781, at \*38, 4 (E.D. Tex. Sep. 18, 2014).

<sup>74</sup> *Id.* at 4 (quoting S. Rep. 1010-460, 1990 WL 201710 (1990)).

Judge Forrest in *Ulbricht*. Judge Rakoff made sure to specifically state that bitcoins are money, and actually cited to persuasive authority for the first time (albeit he bypasses the previous Southern District case in favor of *SEC v. Shavers*).

However, what makes the *Faiella* opinion unique, compared to *Shavers* and *Ulbricht*, is that the “ordinary” definition used is much more inclusive than either of the previous cases. Where *Shavers* simply stated a practical common knowledge view that bitcoins are money because they act like money, *Ulbricht*, while not citing to *Shavers*, seemed to solidify the notion that bitcoins are money by using a dictionary definition.<sup>75</sup> It appears not all dictionary definitions are created equal though. *Ulbricht* used the Cambridge dictionary to determine that “funds” are defined as “money” and “money” is defined as “an object used to buy things”<sup>76</sup> *Faiella* (most likely intentionally) used a much broader definition from Merriam dictionary:

“[M]oney” in ordinary context means “something generally accepted as a medium of exchange, measure of value, or a means of payment. Prominently, an example of money include “money of account” which is “a denominator of value or basis of exchange which is used in keeping accounts and for which there may or may not be an equivalent coin or denomination of paper money.” “Funds” were also defined as “available money [or] an amount of something that is available for use: a supply of something.”<sup>77</sup>

The difference is immediately apparent between both definitions. While the Cambridge definition (money

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<sup>75</sup> See *SEC v. Shavers*, 2014 U.S. Dist. at 4-5, *Contra United States v. Ulbricht*, 2014 U.S. Dist. at 70

<sup>76</sup> *United States v. Ulbricht*, 2014 U.S. Dist. LEXIS 93093, at \*1-2, 70 (S.D.N.Y. July 9, 2014) (citing *Cambridge Dictionaries Online*).

<sup>77</sup> *United States v. Faiella*, No. 14-cr-243, 2014 U.S. Dist. LEXIS 116114, at 2-3 (S.D.N.Y. Aug. 18, 2014) (quoting *Merriam Online Dictionary*).

is an object used to buy things) seems very broad, the Merriam version (something accepted as a medium of exchange or payment means) goes even further, even implying that if bitcoins were simple bartering chips that they would be classified as money.

*Faiella* also attempts to use legislative intent to bolster its conclusion. It is a creative effort to use a Senate Report from 1990 that references “evolving threats,” but it’s very likely this would not hold water in a Court of Appeals because of the large time span since it was authored and the creation of bitcoin in 2008, especially with how fast digital progress occurs year to year.<sup>78</sup> *Faiella*, was the final of three U.S. District Court cases to address the classification of bitcoins, and it was the first to start using persuasive judicial and legislative authority. It is likely that the case will be used as reference point for future cases whether they be in a District or Court of Appeals.

## B. THE EXECUTION

The United States Department of Treasury Financial Crimes Enforcement Network or FinCEN was the first regulatory body to issue a statement regarding bitcoins. FinCEN issued a Guidance on March 18, 2013, concerning FinCEN’s regulations involving exchanging or using virtual currencies.<sup>79</sup> The Guidance makes no reference to bitcoins, but discusses in depth virtual currencies, which includes bitcoins.<sup>80</sup> The Guidance’s purpose was to clarify the applicability of the regulations that implement the Bank Secrecy Act (“BSA”) to persons “creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies.”<sup>81</sup> The guidance does not go as far to quantify virtual currency as property, but it

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<sup>78</sup> See S. Rep. 1010-460, 1990 WL 201710 (1990).

<sup>79</sup> *FinCEN Guid.* FIN-2013-G001, 1 (Mar. 18, 2013), [http://fincen.gov/statutes\\_regs/guidance/pdf/FIN-2013-G001.pdf](http://fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf).

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

does state that virtual currency is not “real” currency or legal tender.<sup>82</sup>

Under FinCEN regulations, currency (also described as “real currency”) is defined as “coin and paper money of the United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in [its] country of issuance.”<sup>83</sup> FinCEN contrasts currency to “virtual currency” by defining virtual currency, for the first time, as “a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency.”<sup>84</sup> The Guidance continues to note that “virtual currency does not have legal tender status in any jurisdiction.” Further, virtual currencies that have “an equivalent value in real currency, or act[] as a substitute for real currency” are referred to as “convertible virtual currency.”<sup>85</sup>

The FinCEN Guidance has been used as support in several United States District Court cases to help argue that bitcoins do not qualify as money, but as property. While the Guidance holds only persuasive authority because it only concerns the implementation of the BSA (more on the BSA later), a main distinction in the judicial definitions of currency versus the FinCEN definition is the element of a country of issuance.<sup>86</sup> However, even though the FinCEN does not wish for bitcoins to be an official currency, they may still wish to have them treated as money for crime enforcement, thus, making the distinction between currency and money null. Courts have looked to the plain ordinary or dictionary meanings of money, which for the most part only requires an item to be a medium of exchange, where under FinCEN a real currency must be backed by the trust of a sovereign nation. Further, the FinCEN Guidance makes no reference to what virtual

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<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

currencies are classified as, and nowhere in the Guidance can the word “property” be found.<sup>87</sup>

Ironically enough, the FinCEN Guidance requires those who exchange bitcoins to register as Money Services Businesses, which is a type of financial institution that deals with cash, checks or currency exchanges.<sup>88</sup> Although the FinCEN Guidance gives bitcoins a sub-currency like designation, it is clear that the department wishes bitcoins to be treated much closer to money or cash than as property as the IRS and others may hope, as well as why Courts have not been persuaded to consider bitcoins as property.

Bitcoins currently do not have status as legal tender in any one jurisdiction, but they are being used as a form of money in many.<sup>89</sup> In March 2014, the IRS ruled that virtual currency, including bitcoins, should be treated as a form of property instead of actual money.<sup>90</sup> This means that bitcoins could begin acting more as stock and less than an item that immediately trades for goods and services.<sup>91</sup> This unfortunately raises undesirable tax issues such as appreciation, and much more record keeping for legal transactions.<sup>92</sup> For Example, if a person bought \$10 worth of bitcoins, and the bitcoins appreciate in value to \$500, and then are used to buy a deluxe easy bake oven. The \$490 realized is now a taxable profit as far as the IRS is concerned. It is likely many may try to ignore the tax consequences because bitcoins are not in heavy circulation at the moment, but such a scenario could be a huge stumbling block to the success of virtual currency in the mainstream. The IRS’s Notice by far is the most direct regulatory opinion classifying bitcoins as property and not money. This has made it a favorite of defendants in court

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<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 3.

<sup>89</sup> Internal Revenue Service, *I.R.S. Note*. 2014-21, 1 (Mar. 25, 2014), <http://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

<sup>90</sup> *Id.* at 2.

<sup>91</sup> Alex Hern, *Bitcoin is legally property, says US IRS. Does that kill it as a currency?*, *The Guardian* (Mar. 31, 2014), <http://www.theguardian.com/technology/2014/mar/31/bitcoin-legally-property-irs-currency>.

<sup>92</sup> *Id.*



arguing against money laundering charges, but the persuasive authority of the IRS's ruling on criminal law seems to be limited at best.

The Federal Elections Commission ("FEC") also released a recent advisory opinion on bitcoins after a federal Political Action Committee submitted the question of whether federal political committees and candidates may accept bitcoin donations.<sup>93</sup> The FEC decided to allow bitcoin donations, but avoided classifying them as money or non-money directly stating they concluded bitcoins are "money or anything of value" under the Federal Election Campaign Act.<sup>94</sup> However, the advisory opinion also stated that for reporting purposes, bitcoins should be reported as in-kind donations and not cash.<sup>95</sup> However, this is likely meant to solve the problem of fluctuating bitcoin value and the "cash on hand" reporting requirement of PACs. Interestingly enough, a bitcoin worth \$50 donated to a PAC, would be allowed to appreciate to \$5000 and be converted to cash without issue despite the \$2600 cash limit on contributions.<sup>96</sup>

The Security Exchange Commission ("SEC") is primarily responsible for enforcing federal securities law and regulating the securities industry and stock and options exchanges, including electronic security markets.<sup>97</sup> The SEC has used the Securities Act of 1933, 15 U.S.C. § 77a, and Securities Exchange Act of 1934, 15 U.S.C. § 78a, as a basis to prosecute at least one offender who created a Ponzi scheme that involved investing in bitcoins.<sup>98</sup> As seen above, the Court found these laws to have authority over bitcoins and other virtual currency. In order to do this, the

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<sup>93</sup> Len E. Goodman, F.E.C. Op. 2014-02 (May, 8, 2014), <http://saos.fec.gov/aodocs/2014-02.pdf>.

<sup>94</sup> *Id.* at 2. See 2 U.S.C. § 431(8)(A)(i); see also 11 C.F.R. § 100.52(d)(1).

<sup>95</sup> *Id.* at 8.

<sup>96</sup> *Id.*

<sup>97</sup> *About the SEC: What We Do*, U.S. Securities and Exchange Commission, <http://www.sec.gov/about/whatwedo.shtml> (last visited Jan. 10, 2015).

<sup>98</sup> See Securities Act of 1933, 15 U.S.C. § 77a, see also Securities Exchange Act of 1934, 15 U.S.C. § 78a. *SEC v. Shavers*, 2014 U.S. Dist.

*Shavers* Court had to declare that bitcoins were indeed money, and therefore under the jurisdiction of these laws. The SEC seems more in line with the FinCEN in their desired treatment of bitcoins as both would prefer the currency to be treated more like cash money, in contrast to the IRS's newfound position which advocates for bitcoins to be treated as property.

### C. POWER TO THE PEOPLE

The United States legislative branch has not passed any definitive law concerning bitcoins whatsoever at this time.<sup>99</sup> Congressional action on bitcoin has been limited to only two occasions where the Senate Committee on Finance, in May 2013, and the Homeland Security and Governmental Affairs committee, in August 2013, sent letters to various federal agencies to survey their treatment of virtual currencies.<sup>100</sup> Both of these actions took place before the IRS issued their 2014 Notice and their results lacked a clear consensus and answer as to how virtual currencies were to be treated for tax reporting purposes and national security threats.<sup>101</sup>

The Congressional Research Service prepared a report specifically on bitcoins (not virtual currency in general) on July 15, 2014.<sup>102</sup> While the report is not in any fashion binding law, it will likely be the first resource used by lawmakers as it is prepared specifically for members of congress, assuming congress can pass a law before the information becomes outdated in the fast moving digital world. While the report did not make any definitive statement as to whether bitcoins should be classified as money instead of property, the report at times simply referred to bitcoins as "digital money" as well as "currency."<sup>103</sup> However, the report omits any reference to the recent IRS Notice 2014-21 even though it was

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<sup>99</sup> Craig Elwell, Cong. Research Serv., R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues, 9 (2014).

<sup>100</sup> *Id.* at 9.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at ii.

<sup>103</sup> *Id.* at 9.

published after the notice. The Congressional Service Report also recognized that the status of bitcoins is still up to determination when it referenced the above *Shavers* decision stating “[the SEC] successfully convinced a federal district court that bitcoins are money.”<sup>104</sup> The report also quickly notes that bitcoins are not legal tender, and no merchant is required to accept them as a form of payment, unlike the actual U.S. dollar.<sup>105</sup>

A central power of the congress, granted by the U.S. Constitution, is its authority to “coin money [and] regulate the value thereof.”<sup>106</sup> Although no specific law has been passed to regulate bitcoins or other virtual currencies, bitcoins are finding treatment under two main areas of law: Federal Anti-Money Laundering laws and Federal Taxation law.

Federal Anti-Money Laundering laws such as 18 U.S.C. § 1956 and 1957 prohibit engaging in financial transactions that are designed to finance illegal activities or involve proceeds of such activities.<sup>107</sup> Most money laundering crimes involve financial institutions, which triggers transaction reporting requirements under the Bank Secrecy Act (“BSA”).<sup>108</sup> The Currency and Foreign Transactions Reporting Act complements the BSA by requiring these financial institutions, designated as “money services businesses” (“MSBs”), to file suspicious activity reports when cash transactions break certain monetary thresholds set by the Secretary of Treasury office.<sup>109</sup> MSBs may include check cashers, foreign currency exchangers, traveler’s and cashier’s check issuers, prepaid cards, and money wire transmitters.<sup>110</sup> MSBs are all required to register with the Department of Treasury.

At first glance, it may not appear that the BSA concerns bitcoins at all. However, as previously

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<sup>104</sup> *Id.* at 11.

<sup>105</sup> *Id.* at 6.

<sup>106</sup> U.S. CONST. art. I, § 8, cl. 5.

<sup>107</sup> 18 U.S.C. § 1956–1957 (2016).

<sup>108</sup> Craig Elwell, Cong. Research Serv., R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues, 9, 14 (2014).

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

referenced, FinCEN has used the BSA as their legal authority to require bitcoin exchanges that convert U.S. or foreign currency into bitcoins or vice versa to be registered as an MSB.<sup>111</sup> This was memorialized in the FinCEN Guidance issued on March 18, 2013 concerning virtual currency.<sup>112</sup> Such an action does not appear to stretch the law either because the purpose of the BSA is to deter under the table, cash or cash-like, financial transactions. Bitcoins can readily be exchanged for US currency, and therefore, would need to be treated as a form of cash under the law to avoid easy exploitation of anti-money laundering laws. Whether or not this cash-like treatment of bitcoins under the BSA can be used to bolster an argument against the IRS's recent declaration that bitcoins are to be considered property is yet to be seen.

As discussed above, the Securities Act of 1933 and the Securities Exchange Act of 1934 have been successfully proven in court to apply to bitcoins and virtual currencies of the like.<sup>113</sup>

The tax law applicable to bitcoins is limited to the IRS's recent Notice 2014-21. Congress has passed no statute or federal taxation code regulation specifically addressing virtual currencies. Currently the federal taxation law regarding bitcoins is solely vested in the IRS's treatment of the currency, which leaves the bitcoin designation as property for tax reporting purposes as discussed in the previous section. Unlike the FinCEN that uses anti-money laundering laws as the basis of its virtual currency treatment, the IRS did not include in its Notice the general tax law it used as authority to couple bitcoins into the property designation.<sup>114</sup> Calls to the IRS Notice Author Keith Aqi for further comment have not been returned as of Mar. 4, 2015.<sup>115</sup>

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<sup>111</sup> *FinCEN Guid.* FIN-2013-G001, 1 (Mar. 18, 2013), [http://fincen.gov/statutes\\_regs/guidance/pdf/FIN-2013-G001.pdf](http://fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf).

<sup>112</sup> *Id.*

<sup>113</sup> *SEC*, 2014 U.S. Dist. LEXIS 130781, at \*3-4.

<sup>114</sup> Internal Revenue Service, *I.R.S. Note*. 2014-21, 1 (Mar. 25, 2014), <http://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

<sup>115</sup> *Id.* at 6.

International law is also a concern for bitcoin's future because virtual currency has no geo-political bounds. A recent study by the European Central Bank (similar to the United States' Federal Reserve) speculated that based on the growth of virtual currency, international regulation will be inevitable.<sup>116</sup> The International Monetary Fund ("IMF") currently is not permitted to acquire currency not issued by one of its members. Some concern has been raised over the IMF's ability to combat a speculative attack via virtual currency such as bitcoin against the traditional currency on one of its member countries.<sup>117</sup>

#### D. CO-EQUAL SOVEREIGNS AT-LARGE

Several states have begun regulating bitcoins, with even more following suit every year.<sup>118</sup> The typical issue state regulators face is whether bitcoins fall under current money transmission statutes or whether new regulations are required to monitor bitcoin use and prevent possible money laundering and fraud.<sup>119</sup> Some states, like Texas, have simply issued Guidance's suggesting that bitcoins do not qualify as money and therefore businesses dealing in bitcoins do not need money transmitter licenses.<sup>120</sup> However, other states, such as Washington, have decided

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<sup>116</sup> European Central Bank, "*Virtual Currency Schemes*," (October 2012), <http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf>.

<sup>117</sup> Craig Elwell, Cong. Research Serv., R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues, 9, 16 (2014).

<sup>118</sup> Peter Luce, *State Virtual Currency Regulatory Heat Map*, Payment Law Advisor (Dec. 19, 2014), <http://www.paymentlawadvisor.com/2014/12/19/state-virtual-currency-regulatory-heat-map/>.

<sup>119</sup> *Id.*

<sup>120</sup> However, businesses that deal in converting virtual currency to another country's currency do need to obtain a money transmitter license. Jerry Wang, *State of Texas Issues Memorandum on Virtual Currencies*, Payment Law Advisor (April 14, 2014), <http://www.paymentlawadvisor.com/2014/04/14/state-of-texas-issues-memorandum-on-virtual-currencies/>.

that bitcoins (and all virtual currencies) do fall within their money transmitting statutes and therefore businesses that deal in bitcoin exchange have been required to apply for money transmitter licenses.<sup>121</sup>

Two states that have particularly led the charge in bitcoin state monetary policy are New York and California.<sup>122</sup> New York, one of the major financial hubs of the world, is currently gearing up for a massive bitcoin licensing regime.<sup>123</sup> Meanwhile, California has recently become the first state enacting law that gives virtual currency legal money status as opposed to mere legal tender or currency status.<sup>124</sup> Similar paths may follow or are already paving the way like California and New York. Furthermore, Texas' designation of virtual currency as non-money could cause unintended consequences in their state courts.

#### I. EMPIRE STATE OF MIND

New York proposed its first major bitcoin or virtual currency regulations on July 17, 2014 and then, after comment period, released proposed updates on February 4, 2015.<sup>125</sup> The proposed regulations were issued by the New York Department of Financial Services ("NYDFS").<sup>126</sup>

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<sup>121</sup> Luce, *supra* note 115.

<sup>122</sup> Craig Elwell, Cong. Research Serv., R43339, Bitcoin: Questions, Answers, and Analysis of Legal Issues, 9, 11 (2014).

<sup>123</sup> Stan Higgins, *New York Reveals BitLicense Framework for bitcoin Businesses*, Coindesk (July 17, 2014),

<http://www.coindesk.com/new-york-reveals-bitlicense-framework-bitcoin-businesses/>.

<sup>124</sup> Pete Rizzo, *California Governor Grants bitcoin 'Legal Money' Status*, Coindesk (June 29, 2014),

<http://www.coindesk.com/california-governor-grants-bitcoin-legal-money-status/>.

<sup>125</sup> Higgins, *supra* note 120; see Pete Rizzo, *Breaking Down New York's Latest BitLicense Revision*, Coindesk (Feb. 4, 2015), <http://www.coindesk.com/breaking-down-new-york-bitlicense-revision/>.

<sup>126</sup> New York State Department of Financial Services, *Regulations of the Superintendent of Financial Services: Virtual Currencies*, Title 23, Ch. 1, Pt. 200 (Proposed Feb 4, 2015).

The main thrust of the proposed rules is that businesses “that receive, transmit, store or convert virtual currency for customers; buy and sell virtual currency as a customer business; control, administer or issue a virtual currency; or perform conversions between bitcoin and fiat or any value exchange will need to be licensed to operate in New York.”<sup>127</sup> The revised version made an exception for virtual currency software developers, persons using bitcoin for “non-financial means,” and possible conditional licenses for virtual currency startup companies.<sup>128</sup> Further, Merchants that merely accept bitcoins as a form of payment are not subject to the proposed licensing requirements nor are merchants that use bitcoins for investment purposes only.<sup>129</sup> For the most part, the proposed regulations appear aimed at entities solely involved in making money (outside of long-term investment) from virtual currencies themselves.

Record keeping methods to prevent fraud and money laundering are the main tools of the NYFDS regulations. Accounts and transaction records with verified party identities, capital and balance statements, as well as quarterly financial reports are all expected to help bring virtual currency into the monetary mainstream.<sup>130</sup> Further, all transactions involving value over \$10,000 are expected to be reported the day of their request.<sup>131</sup> The NYFDS’ revised regulations are only subject to comment for only 30 days, and will likely go into effect without much change from this point.<sup>132</sup> NYFDS’ rules and regulations are important because many states that have not undertaken virtual currency guidance will likely be influenced by such a large state with a booming financial sector. While the proposed rules in regulations do not specify that bitcoins are money, from the treatment they are receiving from the NYFDS, it’s all but implied that bitcoins and bitcoin related business’ are being considered

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<sup>127</sup> Luce, *supra* note 115.

<sup>128</sup> Rizzo, *supra* note 122.

<sup>129</sup> Luce, *supra* note 115; *see* Rizzo, *supra* note 122.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> Rizzo, *supra* note 122.

in the same manner as businesses that deal in cash money exchange.

## II. THE GOLDEN STATE

California has become the first state to legally recognize bitcoins and other virtual currencies as legal money.<sup>133</sup> Assembly bill 129 was signed into law on June 28, 2014, which recognized nontraditional mediums of value as actual money such as rewards points and digital currencies, which were technically illegal under previous unenforced law.<sup>134</sup> However, the measure was largely symbolic because the law does nothing to regulate bitcoins further, besides slapping a monetary label on them.<sup>135</sup> Still, in terms of the classification of bitcoins as money, it certainly sets a precedent for other states and even the federal government.

The actual regulation of virtual currency in California will come from the California Department of Business Oversight (“DBO”), which has yet to formally rule on virtual currency regulations, but has given some hints as to the direction it’s taking.<sup>136</sup> The DBO has indicated that it is currently exploring options for how it would license bitcoin operators and how virtual currencies fit into *current* California money transmitter regulations.<sup>137</sup> However, in response to rumors that Coinbase, a prominent bitcoin exchanger, received regulatory approval to operate a bitcoin exchange in California, the DBO affirmed that while bitcoin exchanges are permissible as of January 2015, the DBO has still not decided whether or not

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<sup>133</sup> A.B 129, Ch. 74 Gen. Assmb. (Ca. 2014).

<sup>134</sup> Pete Rizzo, *California Governor Grants bitcoin Legal Money’ Status*, Coindesk (June 29, 2014), <http://www.coindesk.com/california-governor-grants-bitcoin-legal-money-status>.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> Stan Higgins, *California Regulator: Coinbase Exchange ‘Not Regulated or Licensed’*, Coindesk (Jan. 27, 2015), <http://www.coindesk.com/california-regulator-coinbase-exchange-regulated-licensed/>.



to regulate such exchanges under California's money transmission statutes.<sup>138</sup>

#### V. THE GOOD, THE BAD, AND THE BITCOIN

Bitcoins are the first viable form of virtual or digital currency that does not have a third party regulator. This allows for greater anonymity (but not total) as well as greater uncertainty in the value of bitcoins. It is likely the use of bitcoins will continue to grow, but the prospect of over-regulation by the IRS and other regulatory bodies could be a threat to their use in large quantities or mainstream commercial transactions. Alternatively, the continuing classification of bitcoins as money or currency by the Courts could make its use unattractive to criminals as well. All of this is not even tied to the extreme volatility of bitcoins as an item of value either.

It is clear that the IRS is resisting the classification of bitcoins as actual money or currency. Contrast this to the SEC and FinCEN that for the purpose of crime enforcement are much more apt to have bitcoins treated like cash or securities involving money. SEC went as far as suing an individual in court to prove bitcoins are money under the law. Perhaps this does not matter for the purpose of taxation, but at some point the IRS will likely find itself in court over a tax crime involving bitcoins, even if it is just a failure to pay property tax. When this day comes, supposing congress has not yet acted, it will be highly probable that there will be a majority of case law and other treatment by regulatory bodies designating bitcoin as cash-money type asset and not capital.

On the other hand, Federal Courts see no reason to dive into the technicalities of virtual currency. The reasoning of all three main District Court opinions concerning bitcoin can be summed up as: if it looks like a duck, walks like a duck, and quacks like a duck... it is a duck. The no nonsense, practical approach of the District Courts is likely to continue, especially with the *Faiella* opinion using the most persuasive authority in its analysis; look for the *Faiella* opinion to pop up in most future bitcoin

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<sup>138</sup> *Id.*

classification cases because it used the most authority and most encompassing definition for “money” (as well as rebutting any claim that money should be construed as a technical legal term of art).<sup>139</sup>

It appears a technical refusal of bitcoin as property (involving the details of software engineering and reasoning of regulatory bodies) may be reserved for the Appellate Courts or a very overzealous District Court judge. However, it appears that bitcoins will likely stay as money for the purpose of criminal charges because it would be a heavy toll on public policy to allow drug traffickers and conspirators to get away with money laundering because in the semantic technical sense they are not dealing with *real* money. This leads to the speculation that bitcoins will almost certainly stay classified as money in the Federal Courts. How this may affect future tax law if and when bitcoins become mainstream is up to dispute.

While it may not be something that matters initially, eventually there will be a legal action that intertwines criminal and tax law that will require the issue of whether bitcoins are classified as money or property to be addressed. This note predicts it will occur in the federal courts within the next 20 years if the issue is not congressionally settled. When a court finally hears the bitcoin classification issue, the IRS’s property definition will likely be outbalanced by the forming precedent.

The legislative branch is in a unique position because they will ultimately be the last ones to act on bitcoin law, but will also have the final authority on the subject as well. It would be naïve to believe that no regulation will occur from bitcoin legislation. Bitcoins and virtual currency of the like will be regulated, as is every new legal entity or conception. The question is how, and will it be constitutional? Certain state legislatures have already taken the lead to classify bitcoins as legal money, but real treatment of the currency is being left up to state regulators anyway, so the gesture may merely be symbolic.

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<sup>139</sup> *United States v. Faiella*, No. 14-cr-243, 2014 U.S. Dist. LEXIS 116114 (S.D.N.Y. Aug. 18, 2014).

There will also be a number of unseen interests involved when creating the first bitcoin legislation. These will include the governmental interests that favor bitcoin regulation such as the SEC, IRS, FinCEN, FEC, and even state governments could be affected. Based off of the actions and publications from the various regulatory bodies, the IRS will likely be the only one to favor a property designation. However, there is no downside for the SEC or FinCEN if bitcoin can constitutionally maintain its tax status as property and still be considered as money for criminal prosecutions and civil recoveries. In a perfect world, the government would get more tax revenue, and prosecute citizens as they find most convenient. Other balancing interests include U.S. citizens that use bitcoins, especially U.S. businesses that accept bitcoins and may face adverse tax consequences. North America's major bitcoin exchanger, Coindesk, as well as other bitcoin arbitrators such as Bitpay, will all have high stakes in future bitcoin regulations. Most nongovernmental entities will likely favor a monetary treatment of bitcoins for all legal occasions.

## VI. THE FUTURE IS NOW

The federal courts seem unlikely to budge in their classification of bitcoins as money. The logical follow up question is: why should they? Most cases that find themselves debating the legal status of bitcoin involve drug trafficking money launderers or Ponzi scheme operators; all of which come charging into court with the IRS notice or FinCEN guidance claiming bitcoins cannot be money. However, bitcoins are a new creation, and it is the judge's job to "discover" the law through a multitude of factors, including public policy, until lawmakers say contrary.

Bitcoins are a situation where blind reading of regulatory directions would lead to absurd results. Bitcoins are already a magnet for controversial and illegal purchases because of their difficulty to track. To allow a legal cloud for online criminal activities would create a situation that the bitcoin creator and core developers never

intended. Money launderers and scammers could walk free on a mere technicality of diction and aging statutes under a strict interpretation of money. From the District Court opinions, this notion has not been lost on the judiciary either. There is simply no way drug traffickers, money launderers and investment con-artists are going to avoid justice so contritely. If an Appellate Court ever heard the issue, an affirmation of bitcoins as money would be a mere formality to set a higher precedent. The attorneys of these defendants must obviously feel that there is enough conflict in the IRS Notice and other regulatory publications to mean something. However, according to the decisions of the federal courts, what they likely mean is that the current tax treatment of bitcoins is in danger. If bitcoins are ever to be universally classified as property and not money, the decision is not going to come from the federal courts.

Regulatory publications are not all encompassing nor fully consistent either. While the FinCEN Guidance does not go as far as stating bitcoins are money, it does require those business dealing in bitcoin currency exchange be registered as money service businesses in order to be regulated under the Bank Secrecy Act.<sup>140</sup> FinCEN can refuse to label bitcoins as money until the cows come home, but the purpose of the BSA is to regulate the flow of cash money, and by including bitcoins, they are effectively labeling it as *de facto* cash money. The FEC opinion allowing political campaigns to accept bitcoins as donations left the question of their money status up to interpretation. The opinion itself described, bitcoins as “money or anything of value,” but for FEC reporting purposes, the donations should be reported as “in-kind” or property donations.<sup>141</sup> While this may lean in favor of treating bitcoins as property, it was likely not intended to be a definitive answer, but a solution to fluctuating bitcoin

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<sup>140</sup> *FinCEN Guid.* FIN-2013-G001, 1 (Mar. 18, 2013), [http://fincen.gov/statutes\\_regs/guidance/pdf/FIN-2013-G001.pdf](http://fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf).

<sup>141</sup> Len E. Goodman, F.E.C. Op. 2012-02 (May, 8, 2014), <http://saos.fec.gov/aodocs/2014-02.pdf>.

value and the “cash on hand” reporting requirement of political campaigns.

Finally, there is the IRS Notice proclaiming that bitcoins should be treated as property for tax purposes.<sup>142</sup> Treating bitcoins as property and subjecting them to capital gains treatment is not likely to spur their growth, especially as more businesses look to accept bitcoins for payment of normal goods and services. While the criminal law determinations on bitcoin’s money status may seem like a separate realm to some, they will not remain separate forever. At a certain point, a company is likely to sue the IRS for a refund for the difference in tax revenue between capital gains and cash transaction. When this occurs, the appeals court (after the tax court inevitably agrees with the IRS) will look to a multitude of factors for its decision, including public policy and similar court decisions. Does this mean the federal courts will unilaterally strike down the IRS’s tax designation of bitcoins? Perhaps not, but likely so. Like the previous federal judicial opinions that look beyond the strict interpretation of text, the odds do not look great for the IRS. Tax evasion, money laundering, investment fraud, and the like; all go hand in hand. The momentum of the federal judiciary is swinging in favor of classifying bitcoins as money, and public policy supports this. A decision to the contrary (affirming bitcoins as property) is only sure to bring more criminals out of the woodwork claiming precedent against their bitcoin related crimes under money statutes.

#### THE FINAL VERDICT

The future of bitcoins is still uncertain. At certain times, its future looks stable, where bitcoin companies are even sponsoring college football bowl games.<sup>143</sup> On the

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<sup>142</sup> Internal Revenue Service, *I.R.S. Note*, 2014-21, 1 (Mar. 25, 2014), <http://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

<sup>143</sup> Michael Casey, *BitPay to Sponsor St. Petersburg Bowl in First Major bitcoin Sports Deal*, Wall Street Journal, <http://www.wsj.com/articles/bitpay-to-sponsor-st-petersburg-bowl-in-first-major-bitcoin-sports-deal-1403098202>.

opposite end of the spectrum, there is a major bitcoin exchange marketplace declaring bankruptcy after hackers infiltrated its security network.<sup>144</sup> However, what is certain is the fact that a revolution in monetary exchange has begun. There are many roadblocks to virtual currencies mainstream acceptance, but it is no longer a hypothetical venture of a pseudonymous man in his mother's basement. The law will have to play catch up or different agencies will lose synergy in the new challenges that face them when it comes to tax shelters, money service businesses, and money laundering. These early days of bitcoin use will one day be compared to the early days of internet use.

More legal clarity is needed for bitcoins to become a mainstream success. Congress must pass a law verifying the tax regulations, and giving designated authority to regulatory bodies for crime enforcement concerning bitcoins. Without such an action, bitcoins and virtual currency will continue to be used as money in the "wild wild west" of the internet. Bitcoins already operate in the gray lines of regulation and criminality. Tax shelters will become much more frequent if the duties of each regulatory body and tax law is not reformed. Further, the IRS will likely be challenged in court down the road for its inconsistent treatment of bitcoin, whether or not it is actually constitutional.<sup>145</sup>

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<sup>144</sup> Rachel Abrams and Nathaniel Popper, *Trading Site Failure Stirs Ire and Hope for bitcoin*, New York Times (Feb. 25, 2014), [dealbook.nytimes.com/2014/02/25/trading-site-failure-stirs-ire-and-hope-for-bitcoin/](http://dealbook.nytimes.com/2014/02/25/trading-site-failure-stirs-ire-and-hope-for-bitcoin/).

<sup>145</sup> This note is dedicated to my wonderful fiancée Angela Swagler, and in memory of Sterling Earhart.