

## IRS Says More Cryptocurrency Transactions Are Taxable

By Robert W. Wood

If you swapped one kind of crypto for another before January 1, 2018, was it tax free? You didn't get cash, so there shouldn't be any income or gain for the IRS to tax, right? As the IRS mines all the crypto data it is getting and audits you, will they allow it? The tax law was changed by statute to say that starting January 1, 2018, crypto trades are taxable. By implication, doesn't that mean they were tax-free in 2017 and before?

You might think these questions are no longer relevant, since 2017 is long gone. 2017 tax returns were due on April 15 or October 15 of 2018. The normal three-year statute should run three years after filing. But there's a six year statute of limitations that will likely apply to many of these situations. That gives the IRS until sometime in 2024 to audit.

If you didn't file a return at all, of course, the statute of limitation never runs. The same is true if you file fraudulently. Once an IRS audit starts, the IRS routinely asks for extensions of the time to audit. Most tax advisers tell you to agree, even if giving the IRS more time seems like letting a burglar pilfer your house for a while longer before you call the police. If you don't extend, you usually get hit with a very adverse determination that you have to go to court to try to undo.

Thus, the big crypto swap debate is still relevant, and the IRS just confirmed it. On June 18, 2021, the IRS released Chief Counsel Advice 202124008, asking and answering a question: Does an exchange of (i) Bitcoin for Ether, (ii) Bitcoin for Litecoin, or (iii) Ether for Litecoin qualify as a like-kind exchange under Section 1031 of the tax code? You guessed it, the IRS said no, all three of these swaps—involving no cash—were taxable even before 2018.

It's no secret that the IRS is after crypto in a big way, with warnings, and even a series of John Doe Summonses on exchanges. There's even a question now on Form 1040 tax returns. The big tax law that passed in December 2017 made it clear that that swaps of one crypto for another are not tax free starting in 2018. For prior years, the IRS has been asked about this repeatedly but remained mum until now.

Broadly stated, a 1031 or like-kind exchange is a swap of one business or investment asset for another. Under the tax code, most swaps are taxable, just like a sale for cash. That's one reason the IRS has gone after the barter community to tax goods and services that are exchanged. Section 1031, an exception to the rule that swaps are fully taxable, allows you to change the form of your investment paying taxes.

Your tax basis stays the same, switching from what you gave up to what you acquired. That way, your investment continues to grow tax deferred. If you qualify, there is no limit on how many times or how frequently you can do a 1031. Real estate investors roll over their gain from one investment to another. Despite profits on each swap, they avoid tax until they sell for cash years later, paying only one tax, ideally as a long-term capital gain.

The IRS announced in 2014 that crypto is property for tax purposes. That may have been the shot heard round the crypto world. And while there have been limited IRS releases of crypto tax guidance since then, plenty of big questions remain. Some exchanges of personal property, say a painting or a private plane clearly qualified before 2018. Exchanges of corporate stock or partnership interests never did.

Most holders of crypto hold it for investment. The tougher hurdle is whether they swapped for property of like-kind. Swapping silver for gold would be taxable, but different types of crypto are arguably like different types of gold coins. If you could swap of one type of gold coin for another before 2018, why not crypto?

The IRS starts by describing Bitcoin, Ether, and Litecoin. Crypto exchanges allow users to trade one crypto for another, as well as fiat like U.S. dollars. Major crypto like Bitcoin and Ether typically can be traded for any other. However, some can be traded for only a limited number of other crypto and cannot be traded for fiat currency at all.

The IRS notes that one popular exchange supported more than 30 different cryptocurrencies, but almost all could be acquired with or traded for only Bitcoin, Ether, or fiat. In 2017, there were more than 1,000 different cryptocurrencies in existence.

Before 2018, section 1031 applied to some exchanges of personal property. But in 1982 the IRS ruled that an exchange of gold for silver was taxable. Even a swap of one type of gold coin for another was taxed, because one coin's value was derived from its collectability while the other's value was derived from its metal content.

The IRS recites that in 2016 and 2017, Bitcoin and Ether held special positions, as most exchanges required Bitcoin or Ether to trade. An individual seeking to buy other crypto generally had to first buy Bitcoin or Ether. It was similar on sale, swapping first for Bitcoin or Ether. Because of this, the IRS says Bitcoin and Ether each differed in nature and character from Litecoin.

Therefore, the IRS concludes that Bitcoin and Litecoin (BTC/LTC) do not qualify as like-kind property, nor do Ether and Litecoin (ETH/LTC). The IRS goes on to consider Bitcoin and Ether as against each other. They share similar qualities and uses, the IRS says, but are fundamentally different in design, intended use, and actual use.

The IRS says the Bitcoin network is designed to act as a payment network for which Bitcoin acts as the unit of payment. The Ethereum blockchain was intended to act as a payment network and as a platform for operating smart contracts and other applications, with Ether as the fuel, according to the IRS. Ether and Bitcoin are both used to make payments, but the IRS concludes that Bitcoin and Ether are not like-kind property.

There will invariably be questions about other trades, and the IRS does not address them. In fact, the ruling says it only covers Bitcoin, Ether, and Litecoin. Even as to the ones it

covers, this IRS advice to IRS employees is not precedential authority.

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