

**BITCOIN: BREAKING BAD OR BREAKING BARRIERS?**

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*For nearly the past decade, Bitcoin has found itself in a state of non-regulation, ambiguous regulation, and conflicting regulation, with several interested agencies vying for effective regulation of an often misunderstood technology. Early run-ins with large-scale criminal enterprises in large part created the multi-directional regulatory attention Bitcoin “enjoys” today. Even while many businesses and individuals interested in Bitcoin have sought, unsuccessfully, consistent governmental policy, Bitcoin’s popularity has continued to rise, and its relative volatility continues to subside. There is no better time than now for federal agencies to align their stances and policies relating to this technology, establish consistent criminal and civil regulation, and allow Bitcoin to reach its fullest potential: as a form of security.*

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## I. INTRODUCTION

There is a scene in the television show *Breaking Bad*,<sup>1</sup> where a crooked lawyer explains to one of the main characters the mechanics of a money-laundering scheme.<sup>2</sup> “Placement, layering,

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<sup>1</sup> *Breaking Bad* is an American crime drama television series created by Vince Gilligan and originally aired from 2008 to 2013 on AMC.

<sup>2</sup> *Breaking Bad: Kafkaesque* (AMC television broadcast May 16, 2010).

[and] integration” are the only things required to create a clean (and taxable) cash flow untraceable to the drug sales that produced it.<sup>3</sup> The key to this system, the lawyer continued, is paying the Internal Revenue Service (“IRS”) so as not to raise suspicion about the large quantities of money being accumulated.<sup>4</sup> Now imagine a system that could anonymize monetary transactions, without fees from a bank and without taxation from the IRS. To many who prefer dealing in currency that affords privacy, security, independence from bank regulations and fees, and an ease of use in international transactions, Bitcoin has provided just the system. However, like money laundering in *Breaking Bad*, Bitcoin has also been used to conduct illicit activities in the shadows, such as dealing drugs or hiring hitmen on an online black market like Silk Road. The technology of Bitcoin may spur a transformation in the global financial world or, as some argue, it may merely exist as a technology used only by “tech enthusiasts or criminals.”<sup>5</sup> Whether and how Bitcoin is regulated in the future will largely determine the answer to that question and will help determine the resolution to current and future bitcoin-related litigation.

This Recent Development argues that Bitcoin is in dire need of clear categorization and regulation as a security if it is to become a viable form of investment and holder of value. Part II provides an overview of bitcoin technology and its mechanics and details the history of Bitcoin’s interaction with criminal enterprises that have prompted both government and industry pressure for regulation. Part III discusses the legal benefits and implications to applying the interpretations from *United States v. Murgio*<sup>6</sup> and *United States v. Petix*<sup>7</sup> to part or all of bitcoin<sup>8</sup> transactions and the differing

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<sup>3</sup> *See id.*

<sup>4</sup> *See id.*

<sup>5</sup> Katie Collins, *Bitcoin Users Are All Tech Enthusiasts or Criminals, Study Concludes*, WIRED: CRYPTOCURRENCIES (Aug. 3, 2015), [www.wired.co.uk/article/bitcoin-users-criminals-computer-programmers-study](http://www.wired.co.uk/article/bitcoin-users-criminals-computer-programmers-study).

<sup>6</sup> *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128 (S.D.N.Y. Sept. 19, 2016).

<sup>7</sup> *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919 (W.D.N.Y. Dec. 1, 2016).

stances by various U.S. government agencies. Part IV asserts the necessity and benefits of clear U.S. regulation of bitcoin use as a security. Finally, Part V concludes by recognizing that consistent security regulation of Bitcoin will benefit and protect the government, all businesses that utilize Bitcoin, and the public.

## II. BITCOIN MECHANICS AND ITS PROBLEMATIC PAST

The first section describes the working parts of the Bitcoin network and specific roles individuals take throughout the process of creating Bitcoin and in completing transactions. Several of the Bitcoin characteristics described below are the reasons why Bitcoin has garnered both the use of criminals and the attention of federal agencies and prosecutors. The second section highlights the notable and large-scale criminal activity perpetrated with the aid of Bitcoin, all which have led to a growing call to give Bitcoin a specific legal classification as a currency, commodity, or security, in order to effectively regulate its use.

### A. Bitcoin Mechanics

Bitcoin is a relatively new form of digital currency, or cryptocurrency, which is created and held electronically.<sup>9</sup> It was invented through a paper published in November 2008 by an anonymous software developer who goes by the name Satoshi Nakamoto.<sup>10</sup> The electronic bitcoins “allow online payments to be

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<sup>8</sup> “Bitcoin” is capitalized when referring to the network or system of technology and lowercased when referring to units of the virtual currency.

<sup>9</sup> *What is Bitcoin?*, COINDESK (Mar. 20, 2015), [www.coindesk.com/information/what-is-bitcoin/](http://www.coindesk.com/information/what-is-bitcoin/) [hereinafter *What is Bitcoin*].

<sup>10</sup> Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN, <https://bitcoin.org/bitcoin.pdf>. There is much skepticism concerning the true identity of Satoshi Nakamoto, however, the Bitcoin system of currency was designed and operates as a completely open-source technology, thus intentionally making the original creator’s identity moot. See *Who is Satoshi Nakamoto?*, COINDESK (Feb 19, 2016), [www.coindesk.com/information/who-is-satoshi-nakamoto/](http://www.coindesk.com/information/who-is-satoshi-nakamoto/). For those still intrigued, Newsweek Magazine published an article that purported to locate and interview the real Satoshi Nakamoto, a California man of humble and quiet surroundings. However, since interviewed, the man identified by the report retained counsel and subsequently publically

sent directly from one party to another without going through a financial institution,” using a peer-to-peer network to solve the problem of people double spending their currency at the same time.<sup>11</sup> Bitcoins are not minted or printed by a central government or agency like traditional currencies, but instead are “mined,”<sup>12</sup> created when people offer their computer’s processing power to solve mathematical problems, called “proof of work,”<sup>13</sup> required to confirm sequential transactions within the Bitcoin network.<sup>14</sup> The entire transaction system is a decentralized peer-to-peer network, without any institutional control over the network, meaning that large banks cannot control or freeze the currency or transaction.<sup>15</sup> Individuals and businesses can accept Bitcoin as payment for goods and services,<sup>16</sup> and the bitcoin network collects all the transactions made during a set period into a list, called a block.<sup>17</sup>

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denied any involvement. See Leah McGrath Goodman, *The Face Behind Bitcoin*, NEWSWEEK (Mar. 6, 2014), <http://www.newsweek.com/2014/03/14/face-behind-bitcoin-247957.html>.

<sup>11</sup> Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN, <https://bitcoin.org/bitcoin.pdf>.

<sup>12</sup> Bitcoin “mining” is a process by which, approximately every ten minutes, computers collect hundreds of recently requested Bitcoin transactions and verify the transactions by solving a mathematical equation and confirming that the sender of funds in each transaction has the right to spend the specific bitcoins involved. See L.S., *How Bitcoin Mining Works*, THE ECONOMIST (Jan. 20, 2015), <http://www.economist.com/blogs/economist-explains/2015/01/economist-explains-11>.

<sup>13</sup> “Proof of work” is “a piece of data which is [intentionally] difficult (costly, time-consuming) to produce but easy for others to verify and which satisfies certain requirements.” See *Proof of Work*, BITCOIN WIKI, [https://en.bitcoin.it/wiki/Proof\\_of\\_work](https://en.bitcoin.it/wiki/Proof_of_work) (last visited Mar. 4, 2017). The Bitcoin system utilizes the SHA-256 (Secure Hash Algorithm) scheme of proof of work, originally developed and used by the National Security Agency as a secure cryptographic means of data integrity and security. See *SHA-256*, BITCOIN WIKI, <https://en.bitcoin.it/wiki/SHA-256> (last visited Mar. 4, 2017).

<sup>14</sup> *How Bitcoin Mining Works*, COINDESK (Dec. 22, 2014, 6:05 AM), [www.coindesk.com/information/how-bitcoin-mining-works/](http://www.coindesk.com/information/how-bitcoin-mining-works/) [hereinafter *How Bitcoin Mining Works*].

<sup>15</sup> *What is Bitcoin*, *supra* note 9.

<sup>16</sup> Bitcoin allows individuals to accept bitcoins as payment immediately. See *Bitcoin for Individuals*, BITCOIN.ORG, <https://bitcoin.org/en/bitcoin-for->

Developers of bitcoin, or “miners,” offer their computers’ processing power to confirm the block transactions, produce a hash<sup>18</sup> by applying a mathematical equation to the block, and write both the transaction and the hash into a general ledger, or blockchain.<sup>19</sup> The ledger is a chronological tally of all transactions and a copy of the ledger is shared with every computer within the network in order to prevent someone from spending their digital currency twice with different users.<sup>20</sup> The process that requires each new block to be produced by using the prior block’s hash serves as “a digital version of a wax seal.”<sup>21</sup> Although the ledger publically lists all transactions, the names and private information of the parties to a transaction are not automatically linked to the transaction and can be obscured by techniques recommended by the network.<sup>22</sup> Bitcoin’s ability for anonymity has attracted the privacy-hungry and the criminal-minded alike, and with its

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individuals (last visited Feb 16, 2017). More than ninety-eight companies currently accept Bitcoin as payment for goods or services. See Jonas Chokun, *Who Accepts Bitcoins as Payment? List of Companies, Stores, Shops*, 99BITCOINS.COM (Feb. 6, 2017), <https://99bitcoins.com/who-accepts-bitcoins-payment-companies-stores-take-bitcoins/#prettyPhoto>. However, many large well-known companies are accepting Bitcoin, but only by partnering with a middleman like Coinbase, Inc., which accepts the Bitcoin, immediately converts it into U.S. dollars, and deposits the amount into the company’s account. See Jacob Davidson, *No, Big Companies Really Aren’t Accepting Bitcoin*, TIME: EVERYDAY MONEY (Jan. 9, 2015), <https://time.com/money/3658361/dell-microsoft-expedia-bitcoin/>.

<sup>17</sup> *How Bitcoin Mining Works*, *supra* note 14. A “block” is a collection of transactions that have occurred during a set period of time. *Id.*

<sup>18</sup> *Id.* A “hash” is a unique random sequence of letters and numbers that is shorthand for a unique transaction between users that is stored with the block. *Id.*

<sup>19</sup> *Id.* A “blockchain” is a long list of blocks, also commonly referred to as a ledger. *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> See *Protect Your Privacy*, BITCOIN (last visited Jan. 12, 2017), <https://bitcoin.org/en/protect-your-privacy>. For a further detailed discussion on the technical operation of the Bitcoin network, see generally Gregory M. Karch, *Bitcoin, the Law and Emerging Public Policy: Towards A 21st Century Regulatory Scheme*, 10 FLA. A & M U. L. REV. 193, 199-204 (2014).

tremendous growth recently,<sup>23</sup> it has caused concern with U.S. policymakers and regulators, as detailed by advisories, statements, and policies detailed below.<sup>24</sup>

### *B. Illegal Activity Facilitated by Bitcoin*

Criminals have used all forms of currency to attempt fraud, money laundering, or other illegal activities.<sup>25</sup> However, in its relatively brief existence, Bitcoin's allure of anonymity and the speed and ease of its electronic transactions have already inspired several multi-million-dollar criminal enterprises.<sup>26</sup> While the federal prosecutions of criminal enterprises involving Bitcoin are few,<sup>27</sup> they are significant. The earliest felony conviction involving

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<sup>23</sup> See JP Buntinx, *US Regulators Voice Concerns Over Bitcoin Ecosystem Growth*, NEWSBTC BITCOIN NEWS SERVICE (June 22, 2016, 11:00 AM), <http://www.newsbtc.com/2016/06/22/us-regulators-bitcoin-growth/>.

<sup>24</sup> See *infra*, Part III.

<sup>25</sup> The FBI's latest and most comprehensive report on financial crimes show that during fiscal years 2010 and 2011: Corporate fraud accounted for 242 indictments or informations, 241 convictions, and \$2.4 billion in restitution; Securities and commodity fraud accounted for 520 indictments or informations, 394 convictions, and \$8.8 billion in restitution; Financial institution fraud accounted for 521 indictments or informations, 429 convictions, and \$1.38 billion in restitution; and money-laundering accounted for 37 indictments, 45 convictions, and \$18.4 million in restitution. See *Financial Crimes Report 2010-2011*, FBI, <https://www.fbi.gov/stats-services/publications/financial-crimes-report-2010-2011> (last visited Feb. 16, 2017).

<sup>26</sup> See Daniel Roberts, *Bitcoin's First Criminal Goes to Prison Today*, FORTUNE (Mar. 30, 2015), <http://fortune.com/2015/03/30/bitcoins-criminal-prison-shrem/>; Max Plenke, *Drug Sales on the Dark Web Have Tripled Since the Demise of Silk Road*, MIC (Aug. 11, 2016), <https://mic.com/articles/151360/drug-sales-on-the-dark-web-have-tripled-since-the-demise-of-silk-road#.011RsQNJM>; Andy Greenberg, *Read the Transcript of Silk Road's Boss Ordering 5 Assassinations*, WIRED (Feb 2, 2015, 9:31 PM), <https://www.wired.com/2015/02/read-transcript-silk-roads-boss-ordering-5-assassinations/>; see also Michael, *Biggest Bitcoin Heists*, CRYPTOCROOKS (Apr. 2, 2016), <http://cryptocrooks.com/biggest-bitcoin-theft/#.WLeqfRIrKAw> (highlighting the multi-million dollar thefts and fraud perpetrated on and through various Bitcoin exchanges).

<sup>27</sup> A recent search of federal and state cases involving bitcoin on WestLaw produced only fifty-nine cases. See *Search Results*, WESTLAW, <https://1.next.westlaw.com/Search/Results.html?query=bitcoin&jurisdiction=AL>

the use of Bitcoin was of Charlie Shrem<sup>28</sup> in December 2014. Shrem earlier pled guilty to a lesser charge of aiding and abetting an unlicensed money transmitting service, and was convicted and sentenced to two years in federal prison.<sup>29</sup> In coordination with Robert Faiella, Shrem allegedly facilitated the transfer of more than \$1 million in bitcoin money to persons trafficking in drugs on the Silk Road.<sup>30</sup> Shrem also agreed to a forfeiture of \$950,000 to the government in exchange for dropping charges of money laundering and supporting illegal drug operations, which under the Patriot Act would have subjected him to a possible thirty-year prison sentence.<sup>31</sup>

The largest case involving Bitcoin and illegal activity was the Silk Road case, which included billions of dollars in black market drug sales,<sup>32</sup> two federal agents caught (and convicted for) stealing,<sup>33</sup> and murder-for-hire attempts.<sup>34</sup> While the U.S. government claimed a victory in curbing illegal activity facilitated with Bitcoin by shutting down the Silk Road's massive black

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<sup>28</sup> Roberts, *supra* note 26.

<sup>29</sup> Sara Jerving, *Bitcoin Promoter Charlie Shrem Pleads Guilty*, THE WALL STREET J. (Sept. 6, 2014, 9:17 PM), <http://www.wsj.com/articles/bitcoin-promoter-charles-shrem-pleads-guilty-1409870506>.

<sup>30</sup> *See id.*; *see also* United States v. Faiella, 39 F. Supp. 3d 544 (S.D.N.Y. 2014) (detailing the companion case involving Shrem's accomplice).

<sup>31</sup> Joon Ian Wong, *Charlie Shrem to Forfeit \$950k to US Government in Plea Bargain*, COINDESK (Sept. 5, 2014, 17:13 GMT), <http://www.coindesk.com/charlie-shrem-forfeit-950000-us-government-plea-bargain/>.

<sup>32</sup> At the height of drug sales on the Silk Road from February 2011 to July 2013, the site handled approximately \$1.2 billion in transactions. *See* Plenke, *supra* note 26.

<sup>33</sup> Stan Higgins, *Secret Service Agent Gets Six-Year Sentence for Bitcoin Theft*, COINDESK (Dec. 7, 2015, 21:42 GMT), <http://www.coindesk.com/secret-service-agent-gets-six-year-prison-sentence-for-bitcoin-theft/>.

<sup>34</sup> Greenberg, *supra* note 26.

market for drugs, Bitcoin is still available, and other online black markets have tripled the industry since Silk Road's closure.<sup>35</sup>

This continued explosion in illegal activity through the use of Bitcoin, even after a life sentence for the Silk Road creator, signifies that law enforcement alone cannot combat the influence and ability Bitcoin possesses, and that clearly defined regulation is necessary. For those reasons, two concurrent responses have emerged from the high-profile illegal activities perpetrated with Bitcoin: one involves six<sup>36</sup> federal agencies' increased attempts at providing agency guidance and rulemaking, and the other closely-related response involves two<sup>37</sup> agencies' efforts towards maximum criminal prosecution. The following section discusses both responses and their regulatory outgrowths.

### III. CURRENT AGENCY STANCES AND APPLICATION OF CONTRASTING APPROACHES

Several recent cases<sup>38</sup> have interpreted Bitcoin in different ways, and various federal agencies have promulgated<sup>39</sup> oftentimes conflicting guidance on their view of the technology. Section A first provides a comprehensive survey of the current government agency policies and interpretations of Bitcoin. Then, Section B discusses the competing interpretations of Bitcoin technology in recent federal and state litigation across the country.

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<sup>35</sup> Plenke, *supra* note 26.

<sup>36</sup> *See infra*, Part III. This includes the Internal Revenue Service ("IRS"), Treasury Inspector General for Tax Administration ("TIGTA"), Government Accountability Office ("GAO"), Consumer Financial Protection Bureau ("CFPB"), Securities and Exchange Commission ("SEC"), and Commodity Futures Trading Commission ("CFTC").

<sup>37</sup> *See infra*, Part III. This includes the Department of Justice ("DoJ") and the Financial Crimes Enforcement Network ("FinCEN").

<sup>38</sup> *See infra*, Part III, Section B.

<sup>39</sup> *See infra*, Part III, Section A.

*A. Various Agency Interpretations and the Struggle Between Guidance and Prosecution*

This section details the sequence of federal agency interest and action in the area of Bitcoin regulation. It identifies and explains the six official agency categorizations currently promulgated regarding virtual currency, summarizes the purpose and application of each agency's interpretation, and highlights the potential conflicts that exist amongst these agencies. Two conflicting views of Bitcoin emerge from the agency actions below: one is a currency view, the other a property-based view of Bitcoin. Understanding these agency stances will assist in properly evaluating the merits of each view and ultimately leads to the conclusion that a property-based security interpretation of Bitcoin best serves the technology, agency, and individual interests involved.

*1. Internal Revenue Service ("IRS") and Coinbase, Inc. Battle*

In 2014, the IRS released its guidance on its tax treatment of virtual currency, incorporating Bitcoin within its definition of taxable property.<sup>40</sup> This classification means owners of Bitcoin must record their value in U.S. dollars at the time obtained and the time exchanged,<sup>41</sup> and report the capital gain received, subject to a capital gains tax.<sup>42</sup> In fall of 2016, the Treasury Inspector General

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<sup>40</sup> *I.R.S. Notice 2014-21*, IRS, <http://www.irs.gov/pub/irs-drop/n-14-21.pdf> (last visited Feb. 22, 2017).

<sup>41</sup> A practical example of this requirement would be if a Bitcoin miner mined one Bitcoin on January 1, 2016, when it was worth \$433.38, then he or she must report \$433.38 in income on that transaction. If he or she then sold the one Bitcoin on December 31, 2016 when it was worth \$956.23, then he or she must also report capital gains of \$522.85, which is subject to a capital gains tax. *See Bitcoin Price Chart With Historic Events*, 99BITCOINS, <https://99bitcoins.com/price-chart-history/> (last visited Feb. 17, 2017).

<sup>42</sup> The total amount of capital gains (or losses) is reported through the IRS's Form 1040, in Part III, line 16. *See Chapter 16. Reporting Gains and Losses*, IRS, <https://www.irs.gov/publications/p17/ch16.html> (last visited Feb. 17, 2017). The specific information the IRS requires to be retained and/or reported for any virtual currency transaction includes the following: "(1) an indication of what specific virtual currency units were used; (2) the basis for these units, calculated as the fair market value on the day of acquisition; and (3) the date and

for Tax Administration (“TIGTA”) reported that since the use of virtual currencies in taxable transactions has become more common, the IRS should become more involved in regulating Bitcoin.<sup>43</sup> TIGTA recommended, among other things, that the IRS should “develop a coordinated virtual currency strategy” with stated goals and milestone timelines, “provide updated guidance to reflect the necessary documentation requirements and tax treatments” required for virtual currencies, and “revise third-party information reporting documents to [more accurately] identify the amounts of virtual currencies used in taxable transactions.”<sup>44</sup> The Large Business and International Division of the IRS accepted TIGTA’s recommendations and is currently at work drafting a coordinated virtual currency strategy that includes operations by the IRS’s Criminal Investigation Division, with an anticipated implementation date of September 30, 2017.<sup>45</sup>

This response indicates the IRS’s recognition that more guidance and monitoring are necessary to track taxable transactions in virtual currency and to protect against fraud and other criminal activity through the use of virtual currency.<sup>46</sup> Recently, the Government Accountability Office (“GAO”) released a report<sup>47</sup> that faults the IRS for not providing consumers enough guidance regarding the tax liabilities and penalties that can be incurred when using Bitcoin to invest in Individual Retirement

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fair market value of the disposition transaction.” Sam Hampton, *Undermining Bitcoin*, 11 WASH. J.L. TECH. & ARTS 331, 339 (2016); see *Publication 525, Taxable and Nontaxable Income*, IRS, <https://www.irs.gov/pub/irs-pdf/p525.pdf> (last visited Jan. 17, 2017).

<sup>43</sup> Treasury Inspector General for Tax Administration, *As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance* (Sept. 21, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630083fr.pdf>.

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

<sup>45</sup> *Id.*

<sup>46</sup> See *Publication 525, Taxable and Nontaxable Income*, IRS, <https://www.irs.gov/pub/irs-pdf/p525.pdf> (last visited Jan. 17, 2017).

<sup>47</sup> GAO Report, *Retirement Security* (Dec. 2016), <http://www.gao.gov/assets/690/681514.pdf>.

Accounts.<sup>48</sup> The report recommended more proactive guidance by the IRS and other government agencies.<sup>49</sup>

Since the reports commissioned by the TIGTA and GAO, the IRS has taken an increased role in seeking to more closely police Bitcoin transactions, by filing (and securing<sup>50</sup>) a petition to seek a summons of user information from Coinbase, Inc., (“Coinbase”) the most well-known Bitcoin exchange in the U.S., to investigate whether the company’s users underreported or failed to report capital gains from virtual currency transactions between 2013 and 2015.<sup>51</sup> Coinbase attorneys filed a challenge to the “overbroad” demand,<sup>52</sup> and the Coinbase CEO suggested in a public press release that rather than regulating by asking Coinbase to turn over all customer records,<sup>53</sup> the IRS should simply require virtual currency exchanges to issue customers a Form 1099-B<sup>54</sup> like

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<sup>48</sup> *Id.*

<sup>49</sup> *See id.* (“IRA owners who invest in unconventional assets [unknowingly] take on a heightened risk of engaging in a prohibited transaction and losing tax-favored status for their retirement savings.”).

<sup>50</sup> Order granting ex parte petition for leave to serve summons, In re Tax Liabilities of John Does, Civ. No. 3:16-cv-06658-JSC (N.D. Cal. Nov. 30, 2016), <https://www.justice.gov/opa/press-release/file/914226/download>.

<sup>51</sup> Petition Ex Parte for Leave to Serve “John Doe” Summons against All Defendants, In re Tax Liabilities of John Does, 3:16-cv-06658-JSC (N.D. Cal. Nov. 17, 2016), <https://www.plainsite.org/dockets/download.html?id=240290870&z=407d30a3>.

<sup>52</sup> Motion by Proposed Intervenor, In re Tax Liabilities of John Does, Civ. No. 3:16-cv-06658-JSC (N.D. Cal. Nov. 30, 2016), [https://www.scribd.com/document/336476080/Coinbase#from\\_embed?content=10079&ad\\_group=Online+Tracking+Link&campaign=Skimbit%2C+Ltd.&keyword=ft500noi&source=impactradius&medium=affiliate&irgwc=1](https://www.scribd.com/document/336476080/Coinbase#from_embed?content=10079&ad_group=Online+Tracking+Link&campaign=Skimbit%2C+Ltd.&keyword=ft500noi&source=impactradius&medium=affiliate&irgwc=1).

<sup>53</sup> Kelly Phillips Erb, *Coinbase to IRS On Efforts To ID Bitcoin Customers: We Have A Suggestion*, FORBES (Jan. 14, 2017), <http://www.forbes.com/sites/kellyphillipserb/2017/01/14/coinbase-to-irs-on-efforts-to-id-bitcoin-customers-we-have-a-suggestion/#611232d855a6>.

<sup>54</sup> Form 1099-B is the current form required by the IRS to record and report all proceeds from broker and barter exchange transactions. *See Form 1099-B, Proceeds from Broker and Barter Exchange Transactions*, IRS, <https://www.irs.gov/uac/about-form-1099b> (last visited Jan. 16, 2017). For any one transaction this form must be separately filled out by any individual or

brokers do and require the forms from both the company and individuals to report all virtual currency transactions in a calendar year.<sup>55</sup> The resolution of this legal battle may well assist in defining the future steps the IRS will take in better regulating individuals transacting in Bitcoin. However, at least for now this action signals an increased focus by federal agencies like the IRS on individual Bitcoin transactions and portends the potential invasive scale<sup>56</sup> of future Bitcoin regulation.

As one of the earliest agencies to provide the public Bitcoin regulatory guidance, the IRS, through its tax structure, deemphasizes any free-flowing currency notion that Bitcoin might have represented, and instead reinforces and bolsters the security-

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corporation who received value from it, any individual or corporation who exchanged property of services, and any broker and exchange transmitter involved. In fact, the IRS released a question and answer notice regarding virtual currency and has required the use of Forms 1099 to report any payment of \$600 or more in virtual currency for a service received. *See I.R.S. Notice 2014-21*, IRS, <https://www.irs.gov/pub/irs-drop/n-14-21.pdf> (last visited Jan. 16, 2017).

<sup>55</sup> Brian Armstrong, *Coinbase and the IRS*, MEDIUM (Jan. 14, 2017), <https://medium.com/@barmstrong/coinbase-and-the-irs-c4e2e386e0cf#.dmlp2jntp>. Providing more than is required by the IRS guidance discussed in *supra*, note 40, Armstrong suggests that companies like his could easily “issue 1099-B forms at the end of the year to all U.S. customers, and send a copy to the IRS.” *Id.* This, he says, “would make it easy for users of virtual currency to pay their taxes without violating their privacy . . . [because] 1099 forms provide a simple summary of gains or losses on trading activity, [as opposed to] . . . full transaction records, transcripts with customer support, IP addresses, etc.” *Id.* This communication shows a shared effort towards responsible and effective U.S. regulation of Bitcoin by both Bitcoin businesses and a government agency.

<sup>56</sup> The trend toward increasing the oversight and regulation of *individual* Bitcoin transactions was reflected in one state’s initial draft policies, which was sharply criticized as unnecessarily legitimizing a “need to know every time its residents buy or trade money, without even a breath of criminal suspicion,” and whose rules requiring business to confirm user identities would have the absurd effect of “outlawing Bitcoin businesses from using the internet.” Andre Infante, *NYDFS Announces Invasive New Regulations*, COIN REPORT (Jul. 17, 2014), <https://coinreport.net/nydfs-announces-invasive-new-bitcoin-regulations/>; *see also* Press Release, *NY DFS Releases Proposed BitLicense Regulatory Framework For Virtual Currency Firms* (Jul. 17, 2014), <http://www.dfs.ny.gov/about/press/pr1407171.htm>.

like property valuation of Bitcoin.<sup>57</sup> However, as discussed below, the Financial Crimes Enforcement Network (“FinCEN”) has sought to have its cake and eat it too, by stretching Bitcoin exchange businesses into currency transmitting regulation for a broader, albeit more confusing range of available criminal tools.<sup>58</sup>

## 2. *Financial Crimes Enforcement Network’s*<sup>59</sup> (“FinCEN”) “Currency” Treatment of Bitcoin

In 2013, FinCEN held that “[a] user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is *not* a ‘Money Services Business’<sup>60</sup> under FinCEN’s regulation.”<sup>61</sup> This was welcome news for individual Bitcoin miners and users, because it meant they could avoid having to

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<sup>57</sup> See *I.R.S. Notice 2014-21*, <http://www.irs.gov/pub/irs-drop/n-14-21.pdf> (last visited Feb. 22, 2017).

<sup>58</sup> See *infra*, Part III, section A, subsection 1, paragraph 1.

<sup>59</sup> The Financial Crimes Enforcement Network is a bureau of the U.S. Department of the Treasury. *What We Do*, FINCEN, <https://www.fincen.gov/what-we-do> (last visited Feb. 18, 2017).

<sup>60</sup> “MSB,” or Money Services Business, is officially defined as a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (ff)(1) through (ff)(7) of this section. This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States. 31 CFR § 1010.100(ff) (2016). More concretely, an MSB includes, without regard to transaction amount, any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities: (1) Currency dealer or exchanger; (2) Check casher; (3) Issuer of traveler’s checks, money orders or stored value; (4) Seller or redeemer of traveler’s checks, money orders or stored value; (5) Money transmitter; (6) U.S. Postal Service.

*Money Services Business Definition*, FINCEN, <https://www.fincen.gov/money-services-business-definition> (last visited Jan. 17, 2017).

<sup>61</sup> *Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FIN-2013-G001, DEPARTMENT OF THE TREASURY, Financial Crimes Enforcement Network (Mar. 18, 2013), <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>; see also Karch, *supra* note 22.

comply with the “anti-money-laundering, recordkeeping and reporting requirements under FinCEN regulation.”<sup>62</sup> However, digital Bitcoin currency exchanges were required to register with FinCEN as “money transmitters”<sup>63</sup> subject to the Bank Secrecy Act,<sup>64</sup> and to comply with money-laundering regulations as though Bitcoin was a currency and not property as the IRS had previously ruled.<sup>65</sup> FinCEN deemed this decision necessary in order to combat money-laundering by digital currency exchanges, but this classification showcases the internal confusion present among bureaus, even within one department, on the ideal characterization and regulation of digital currency like Bitcoin.<sup>66</sup>

Since that time, FinCEN has issued several rulings applying their guidance to specific questions and have remained steadfast in their view that “in contrast to real currency, ‘virtual’ currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency.”<sup>67</sup> In particular, they concede, virtual currency does not

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<sup>62</sup> Pete Rizzo, *FinCEN Declares Bitcoin Miners, Investors, Aren't Money Transmitters* (Jan. 31, 2014), COINDESK, <http://www.coindesk.com/fincen-bitcoin-miners-investors-money-transmitters/>.

<sup>63</sup> FinCEN defines “Money Transmitter” as “[a] person that provides money transmission services. The term “money transmission services” means the acceptance of currency, funds, or other value that substitutes for currency from one person *and* the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means” or “any other person engaged in the transfer of funds.” 31 C.F.R. § 1010.100(ff)(5)(i)(A) and (B)(2013).

<sup>64</sup> The Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act of 1970 is popularly known as the Bank Secrecy Act (“BSA”). 31 U.S.C. §§ 5311 (2016).

<sup>65</sup> Karch, *supra* note 22, at 232.

<sup>66</sup> FinCEN and the IRS are both bureaus within the Department of the Treasury. *See About*, U.S. DEPARTMENT OF THE TREASURY, <https://www.treasury.gov/about/organizational-structure/bureaus/Pages/default.aspx> (last visited Feb. 20, 2017).

<sup>67</sup> *Application of FinCEN's Regulations to Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals*, FIN-2015-R001, DEPARTMENT OF THE TREASURY, FINANCIAL CRIMES ENFORCEMENT NETWORK (Aug. 14, 2013),

have legal tender status in any jurisdiction.<sup>68</sup> While not executed against Bitcoin specifically, FinCEN directed the first civil enforcement action ever against a virtual currency exchanger, assessing a \$700,000 penalty against Ripple Labs, Inc., for failing to register as a money transmitter with FinCEN.<sup>69</sup> FinCEN coordinated this action with the Internal Revenue Service-Criminal Investigation Division and the U.S. Attorney's Office for the Northern District of California, and the enforcement was based upon a settlement agreement in which the company forfeited \$450,000, but avoided criminal charges under anti-money-laundering statutes.<sup>70</sup> While it is always possible for Congress to alter FinCEN's statutory authority, currently no clear statutory or textual basis exists to support FinCEN's finding that Bitcoin meets any definition of "currency" beyond the mentioned FinCEN rulings.<sup>71</sup>

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[https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2015-R001.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2015-R001.pdf).

<sup>68</sup> *Application of FinCEN's Regulations to Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals*, FIN-2015-R001, DEPARTMENT OF THE TREASURY, FINANCIAL CRIMES ENFORCEMENT NETWORK (Aug. 14, 2013), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2015-R001.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2015-R001.pdf). See also *Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Trading Platform*, FIN-2014-R011, DEPARTMENT OF THE TREASURY, FINANCIAL CRIMES ENFORCEMENT NETWORK (Oct. 27, 2014), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2014-R011.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R011.pdf).

<sup>69</sup> *FinCen Fines Ripple Labs, Inc. in First Civil Enforcement Action Against a Currency Exchanger*, FINCEN (May 5, 2015), <https://www.fincen.gov/sites/default/files/2016-08/20150505.pdf>.

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

<sup>71</sup> See *Application of FinCEN's Regulations to Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals*, FIN-2015-R001, DEPARTMENT OF THE TREASURY, FINANCIAL CRIMES ENFORCEMENT NETWORK (Aug. 14, 2013), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2015-R001.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2015-R001.pdf); see also Department of the Treasury, Financial Crimes Enforcement Network, *Request for Administrative Ruling on the Application of FinCEN's*

Like many stakeholders involved in criminal prosecution who seek to assert greater and greater jurisdictional authority, the IRS's criminal investigation division ignored the IRS's own declaration of Bitcoin as property and sided with FinCEN in order to expand the application and reach of criminal money-laundering regulations to include Bitcoin exchanges.<sup>72</sup> The most recent cases discussed later reflect the aggressive stance taken by U.S. Attorneys and other federal prosecutors to include Bitcoin exchange within the scope of federal money-laundering prosecution.<sup>73</sup>

### *3. Consumer Financial Protection Bureau's ("CFPB") Wait-and-See Approach*

While preventing fraud is one of the chief goals of government agencies' virtual currency regulation, there has not yet been an onslaught of consumer complaints regarding Bitcoin to the CFPB.<sup>74</sup> Still, CFPB has issued advisories to consumers regarding the risks of virtual currency use, and has supported FinCEN's registration requirements of money transmitters and the IRS's ruling of Bitcoin as property.<sup>75</sup> The CFPB considered whether to include virtual currency within the scope of the Electronic Funds Transfer Act and the Truth in Lending Act in one of its rulemakings effective October 1, 2017, but declined to do so.<sup>76</sup>

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Regulations to a Virtual Currency Trading Platform, FIN-2014-R011 (Oct. 27, 2014), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2014-R011.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R011.pdf); FinCEN Press Release (May 5, 2015), <https://www.fincen.gov/sites/default/files/2016-08/20150505.pdf>.

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

<sup>73</sup> See *infra* Part III, section B.

<sup>74</sup> To date, there have only been fifteen consumer complaints concerning virtual currency to the CFPB. See *Consumer Complaints*, CONSUMER FINANCIAL PROTECTION BUREAU, <https://data.consumerfinance.gov/dataset/Consumer-Complaints/s6ew-h6mp> (last visited Mar. 29, 2017).

<sup>75</sup> See *Consumer Advisory (August 2014): Risks to consumers posed by virtual currencies*, CONSUMER FINANCIAL PROTECTION BUREAU, [http://files.consumerfinance.gov/f/201408\\_cfpb\\_consumer-advisory\\_virtual-currencies.pdf](http://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf).

<sup>76</sup> See *Prepaid Accounts under the Electronic Fund Transfer Act and the Truth In Lending Act* (Oct. 3, 2016), CONSUMER FINANCIAL PROTECTION BUREAU,

Some commentators have noted that the CFPB's decision not to include Bitcoin in its rulemaking did not settle the issue with the agency and left open the possibility of regulating Bitcoin in future rulemakings.<sup>77</sup> Thus CFPB's current interpretation firmly plants a foot on either side, echoing the IRS's interpretation of Bitcoin as property, but advising consumers of FinCEN's ruling holding that Bitcoin exchanges fell within the registration requirement for money transmitters as though Bitcoin were a currency.

#### 4. Securities and Exchange Commission<sup>78</sup> ("SEC") Endorses "Property" Treatment of Bitcoin

In 2013 and 2014, the SEC tentatively entered the discussion of Bitcoin when it released a series of investor alerts concerning the susceptibility of Bitcoin transactions to fraud-like Ponzi schemes<sup>79</sup> and the risk of investments involving Bitcoin.<sup>80</sup> In conjunction with the SEC, the Financial Industry Regulatory Authority<sup>81</sup> ("FINRA") also released an investor alert regarding the risks of investing and

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[http://files.consumerfinance.gov/f/documents/20161005\\_cfpb\\_Final\\_Rule\\_Prepaid\\_Accounts.pdf](http://files.consumerfinance.gov/f/documents/20161005_cfpb_Final_Rule_Prepaid_Accounts.pdf); see also Peter Van Valkenburgh, *New CFPB Prepaid Rules Leave Out Bitcoin, and That's Mostly a Good Thing*, COINCENTER (Oct. 5, 2016), <https://coincenter.org/link/new-cfpb-prepaid-rules-leaves-out-bitcoin-and-that-s-mostly-a-good-thing>.

<sup>77</sup> See Van Valkenburgh, *supra* note 76.

<sup>78</sup> The mission of the U.S. Securities and Exchange Commission is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." *What We Do*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/about/whatwedo.shtml> (last visited Feb. 18 2017).

<sup>79</sup> See *Investor Alert: Ponzi Schemes Using Virtual Currency (Jul. 2013)*, U.S. SEC. & EXCH. COMM'N OFFICE OF INV'R EDUC. & ADVOCACY, [https://www.sec.gov/investor/alerts/ia\\_virtualcurrencies.pdf](https://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf).

<sup>80</sup> See *Investor Alert: Bitcoin and Other Virtual Currency-Related Investments*, U.S. SEC. & EXCH. COMM'N (May 7, 2014), [https://www.sec.gov/oiea/investor-alerts-bulletins/investoralertsia\\_bitcoin.html](https://www.sec.gov/oiea/investor-alerts-bulletins/investoralertsia_bitcoin.html).

<sup>81</sup> FinRA is a private corporation that acts as a self-regulatory organization (SRO) that regulates member brokerage firms and exchange markets of the New York Stock Exchange. It is "authorized by Congress to protect America's investors by making sure the broker-dealer industry operates fairly and honestly." See *About FinRA*, FINRA, <http://www.finra.org/about> (last visited Feb. 22, 2017).

transacting in Bitcoin.<sup>82</sup> The SEC publicly supported the IRS's guidance of treating Bitcoin as property.<sup>83</sup> Over the past few years the SEC has become one of the federal agencies heavily involved in enforcement action and has pursued several Bitcoin companies for alleged fraudulent disclosures about business revenue and assets,<sup>84</sup> and for Ponzi schemes or fraud.<sup>85</sup> Most notably, in *Security and Exchange Commission v. Shavers*,<sup>86</sup> the SEC ruled that the conduct perpetrated by the subject Bitcoin exchange constituted an investment in "securities," and therefore the federal district court has subject matter jurisdiction pursuant to Sections 20 and 22 of the Securities Act of 1933<sup>87</sup> and Sections 21 and 27 of the Securities Exchange Act of 1934.<sup>88</sup>

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<sup>82</sup> See *Investor Alert: Bitcoin: More Than a Bit Risky*, FINRA (May 7, 2014), <http://www.finra.org/investors/alerts/bitcoin-more-bit-risky>.

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

<sup>84</sup> See Security and Exchange Commission, Release No. 71568 (Feb. 19, 2014), <https://www.sec.gov/litigation/suspensions/2014/34-71568.pdf>.

<sup>85</sup> See *SEC v. Shavers*, No. 4:13-CV-416, 2013 WL 4028182, (E.D. Tex. 2013), *reconsideration aff'd*, No. 4:13-CV-416, 2014 WL 12622292 (E.D. Tex. 2014).

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

<sup>87</sup> 15 U.S.C. §§ 77t, 77v (2012). These sections concern injunctions, prosecutions, and jurisdiction over securities offenses. "Often referred to as the 'truth in securities' law, the Securities Act of 1933 has two basic objectives: [t]o require that investors receive financial and other significant information concerning securities being offered for public sale; and [t]o prohibit deceit, misrepresentations, and other fraud in the sale of securities." *Registration Under the Securities Act of 1933*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/answers/regs33.htm> (last visited Feb. 22, 2017).

<sup>88</sup> 15 U.S.C. §§ 78u, 78aa (2012). These sections concern investigations, actions, and jurisdiction over securities offenses. In contrast to the Securities Act of 1933, the Securities Exchange Act of 1934 "primarily regulates [security transactions] in the secondary market – that is, sales that take place after a security is initially offered . . . ." Deepa Sarkar, *Securities Exchange Act of 1934*, LEGAL INFORMATION INSTITUTE, [https://www.law.cornell.edu/wex/securities\\_exchange\\_act\\_of\\_1934](https://www.law.cornell.edu/wex/securities_exchange_act_of_1934) (last visited Feb. 22, 2017).

In another complaint, the SEC argued<sup>89</sup> that the defendant's Bitcoin product was a security because it constituted an "investment contract" under the language of the Securities Act's definition of "security."<sup>90</sup> An "investment contract" was originally defined in the landmark case *SEC v. W.J. Howey Co.*<sup>91</sup> In *Howey*, the Supreme Court held that an "investment contract" is "a contract, transaction or scheme whereby a person [(1)] invests his money [(2)] in a common enterprise and [(3)] is led to expect profits [(4)] solely from the efforts of the promoter or a third party . . . ."<sup>92</sup> This definition, and characterization of Bitcoin, has not been refuted up to this point, and shows how easily SEC regulations might apply to Bitcoin.<sup>93</sup>

In the few, but significant, SEC actions involving Bitcoin thus far,<sup>94</sup> the agency has treated Bitcoin as a security and applied anti-fraud and registration provisions of the securities laws, specifically sections 5(a), 5(c), and 17(a) of the Securities Act of 1933,<sup>95</sup> section 10(b) of the Securities Exchange Act of 1934,<sup>96</sup> and Rule 10b-5 of the Exchange Act.<sup>97</sup> Section 5 of the Securities Act of 1933 requires that all issuers of non-exempt securities register with

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<sup>89</sup> See SEC v. Garza, No. 3:15-CV-01760, 2015 WL 7732649 (D. Conn., Complaint filed Dec. 1, 2015) ("[Defendant's Bitcoin products] constitute investment contracts and thus 'securities' under Section 2(a)(1) [15 U.S.C. §77b(1)] of the Securities Act.").

<sup>90</sup> A "security" means among other things "any note, stock . . . security future . . . transferable share, *investment contract* . . . or in general, any interest or instrument commonly known as a security . . . ." 15 U.S.C. § 77b(a)(1) (1933) (emphasis added); see also 15 U.S.C. § 78c(a)(10) (2012).

<sup>91</sup> SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

<sup>92</sup> *Id.* at 298-99.

<sup>93</sup> See, e.g., *United States v. Faiella*, 39 F. Supp. 3d 544 (S.D.N.Y. 2014); *United States v. Budovsky*, No. 13CR368 DLC, 2015 WL 5602853, at \*1 (S.D.N.Y. 2015); *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128 (S.D.N.Y. 2016) (none arguing that Bitcoin does not satisfy the "investment contract" definition).

<sup>94</sup> See, e.g., *Shavers*, *supra* note 85; *Garza*, *supra* note 89.

<sup>95</sup> 15 U.S.C. § 77a (1933).

<sup>96</sup> 15 U.S.C. § 78j(b) (2012).

<sup>97</sup> 17 C.F.R. § 240.10b-5(b) (2015).

the SEC.<sup>98</sup> Section 17(a) of the same act makes it unlawful in the sale of securities to “employ any device, scheme, or artifice to defraud,” to “obtain money or property” by using material misstatements or omissions, or to “engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”<sup>99</sup> Rule 10b-5, promulgated pursuant to Section 10(b) of the Securities Exchange Act of 1934, mostly mirrors the structure and content of Section 17(a) of the 1933 Act. However, 10b-5 claims require proof of scienter and are available as private rights of action, whereas Section 17(a) claims need only meet the negligence standard and cannot be asserted by anyone other than the SEC.<sup>100</sup>

While the SEC is only empowered with civil enforcement and administrative actions,<sup>101</sup> they work closely with—and provide crucial information to—the Department of Justice to pursue criminal enforcement of the federal securities laws.<sup>102</sup> Cases in which the SEC have been involved demonstrate the agency’s robust ability to regulate Bitcoin as a security and assist in federal prosecution of those who use it fraudulently without contorting its existing regulation or redefining “currency” in the process.<sup>103</sup>

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<sup>98</sup> See 15 U.S.C. § 77e (2012).

<sup>99</sup> 15 U.S.C. § 77q(a) (2012).

<sup>100</sup> See SEC v. Morgan Keegan & Co., Inc., 678 F.3d 1233, 1244 (11th Cir. 2012).

<sup>101</sup> “[C]ivil enforcement and administrative actions” alone are no laughing matter. Just recently, the SEC ordered a global construction conglomerate and a petrochemical company to pay a fine of at least \$3.5 billion for government bribery. Press Release, *Odebrecht and Braskem Plead Guilty and Agree to Pay at Least \$3.5 Billion in Global Penalties to Resolve Largest Foreign Bribery Case in History* (Dec. 21, 2016), DEP’T OF JUSTICE, <https://www.justice.gov/opa/pr/odebrecht-and-braskem-plead-guilty-and-agree-pay-least-35-billion-global-penalties-resolve>.

<sup>102</sup> See Linda Chatman Thomsen, Deputy Director, Division of Enforcement, SEC, *An Overview of Enforcement*, SEC, [https://www.sec.gov/about/offices/oia/oia\\_enforce/overviewenfor.pdf](https://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf) (last visited Feb. 18, 2017).

<sup>103</sup> See, e.g., *Faiella*, *supra* note 93; *Budovsky*, *supra* note 93; *Murgio*, *supra* note 93 (none arguing that Bitcoin does not satisfy the “investment contract” definition).

Furthermore, because the SEC works closely with the CFTC, both agencies can easily address options and futures in Bitcoin where regulatory overlap and coordination already occurs.<sup>104</sup>

Recently in March 2017, the SEC rejected an application by well-known investors to create an exchange-traded fund tied to the price of Bitcoin, in large part because the markets where Bitcoin is currently traded is mostly unregulated.<sup>105</sup> The SEC, in its decision, cited the lack of regulation as creating “concerns about the potential for fraudulent or manipulative acts and practices in this market.”<sup>106</sup>

### 5. *Commodity Futures Trading Commission’s*<sup>107</sup> (“CFTC”) Treatment of Bitcoin Options

In asserting jurisdiction over a Bitcoin exchange market in a 2015 enforcement action, the CFTC characterized a Bitcoin option<sup>108</sup> as a “commodity” as defined under Section 1a(9) of the Commodity Exchange Act (“CEA”), and held that Bitcoin “[is]

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<sup>104</sup> See *infra*, Part II, section A, paragraph. 5.

<sup>105</sup> See Nathaniel Popper, *S.E.C. Rejects Winklevoss Brothers’ Bid to Create Bitcoin E.T.F.*, THE N.Y. TIMES (Mar. 10, 2017), [https://www.nytimes.com/2017/03/10/business/dealbook/winklevoss-brothers-bid-to-create-a-bitcoin-etf-is-rejected.html?\\_r=0](https://www.nytimes.com/2017/03/10/business/dealbook/winklevoss-brothers-bid-to-create-a-bitcoin-etf-is-rejected.html?_r=0).

<sup>106</sup> *Id.*

<sup>107</sup> The mission of the U.S. Commodity Futures Trading Commission is to “foster open, transparent, competitive, and financially sound markets,” and works to avoid systemic risk and protect “market users and their funds, consumers, and the public from fraud, manipulation, and abusive practices related to derivatives and other products subject to the Commodity Exchange Act.” *Mission & Responsibilities*, U.S. COMMODITY FUTURES TRADING COMM’N, <http://www.cftc.gov/About/MissionResponsibilities/index.htm> (last visited Feb. 18, 2017).

<sup>108</sup> “Options” are “contracts in which a seller gives a buyer the right, but not the obligation, to buy or sell a specific number of shares at a predetermined price within a set time period.” *Options Defined*, NASDAQ, <http://www.nasdaq.com/investing/options-guide/definition-of-options.aspx> (last visited Feb. 22, 2017). Similarly, a “futures contract” is a legal agreement to “buy or sell a particular commodity or financial instrument at a predetermined price at a specified time in the future.” *Futures Contract*, INVESTOPEDIA, <http://www.investopedia.com/terms/f/futurescontract.asp> (last visited Feb. 22, 2017).

distinct from ‘real’ currencies.”<sup>109</sup> It also determined that some Bitcoin exchanges deal in “commodity options.”<sup>110</sup> Because of these determinations, the CFTC charged Coinflip and its CEO of failing to comply with the Commodity Exchange Act and CFTC regulations for operating a facility for trading or processing “commodity options.”<sup>111</sup> The agency also explicitly joined the IRS in concluding that Bitcoin is not a currency and should not be regulated as such.<sup>112</sup>

While discussing the application of the Commodity Exchange Act to Bitcoin, the CFTC Commissioner was careful to say that the CFTC has a somewhat narrow regulatory authority over Bitcoin: one that focuses only on “contracts for sale of Bitcoin” and “those contracts that are traded on exchanges”—in other words, options and futures contracts in Bitcoin.<sup>113</sup> This recognized approach signals that the CFTC recognizes its limited regulatory application to certain instruments that have Bitcoin as their underlying product.<sup>114</sup>

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<sup>109</sup> The CFTC stated that Bitcoin falls under “other goods and articles . . . and all other services, rights, and interests” portion of the Act’s “commodity” definition. Commodity Exchange Act, 7 U.S.C. § 1a(9) (2014). However, it should be noted that the “rights and interests” portion that could include Bitcoin must be dealt in a “contract for future delivery” in order to meet the complete definition of a commodity. *See* 17 C.F.R. § 240.10b-5(b) (2015).

<sup>110</sup> *See* In the Matter of Coinflip, Inc., Dkt. No. 15-29 (C.F.T.C. Sept. 17, 2015), <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliporder09172015.pdf>.

<sup>111</sup> *Id.*

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

<sup>113</sup> *See* Pete Rizzo, *CFTC Commissioner: Market Manipulation Could Shape Bitcoin’s Future*, COINDESK (Jan. 8, 2015), <http://www.coindesk.com/cftc-commissioner-mark-wetjen-bitcoin/> (Mark Wetjen, CFTC Commissioner, said the following statutory language provides the strongest support for the inclusion of Bitcoin futures contracts within the CEA: “[A] commodity includes any ‘rights or interests in which a contract for future delivery is or will be dealt in,’ and it’s that part of the definition that I think best captures something like bitcoin.”).

<sup>114</sup> *See id.* (stating that “[w]here market participants are simply buying and selling bitcoin on an exchange, we [CFTC] wouldn’t have oversight responsibilities for those exchanges”).

What CFTC's actions and comments further show is that the agency is not intent on burdening Bitcoin users with invasive regulation at every step, nor is it in conflict with the SEC's stance and application of securities regulation.<sup>115</sup> Instead, CFTC simply seeks to apply its regulation to Bitcoin the same way it does to *any* futures instrument, whether or not the underlying product is a commodity or a security.<sup>116</sup> CFTC's rulings and public statements reinforce its market oversight role, and its efforts to investigate questionable activity on Bitcoin exchanges and to weed out fraud perpetrated with Bitcoin options.

#### *6. Department of Justice's ("DoJ") "Full-Indictment Ahead" Approach*

After congressional concerns over the Silk Road, the DoJ established its official position while giving testimony to the U.S. Senate Committee on Homeland Security and Governmental Affairs, that DoJ would prosecute those Bitcoin businesses that failed to obtain state licensing or FinCEN registration under 18 U.S.C. § 1960.<sup>117</sup> The Department representative additionally asserted "the general money laundering statutes, 18 U.S.C. §§ 1956 and 1957, cover financial transactions involving virtual currencies."<sup>118</sup> Since 2013, there have been cases that both support and refute the assertions by the DoJ. They are discussed in detail in the following section.<sup>119</sup>

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<sup>115</sup> See Rizzo, *supra* note 113.

<sup>116</sup> See *id.* (providing that "[i]n an instance where there are manipulative or fraudulent activities in the cash market, that is the type of case where the definition of a commodity comes into play and we [CFTC] can use that authority to prosecute bad behavior in the cash market").

<sup>117</sup> *Beyond the Silk Road: Potential Risks, Threats and Promises of Virtual Currencies: Hearing Before the Comm. on Homeland Sec. and Governmental Affairs*, 113th Cong. (2013) (statement of Mythili Raman, Acting Assistant Attorney General, U.S. Justice Department, Criminal Division).

<sup>118</sup> *Id.*

<sup>119</sup> See *infra* Part III, Section B.

*B. Recent Case Law Development: 50.44 Bitcoins, Murgio, and Petix*

The arguments accepted and offered in recent cases shed light on how judges view virtual currency in certain actions. Following are the most significant cases in the scarce virtual currency litigation to date, and these cases deal with whether or not Bitcoin should be considered “funds,” “currency,” or “property.” The designations supported by these and future cases have considerable impact as to whether and how certain federal statutes will apply to Bitcoin, Bitcoin transactions, and Bitcoin businesses. The first section discusses a recent line of cases that support Bitcoin’s characterization as property. The second section discusses the line of cases that interpret various statutes in order to characterize Bitcoin as money or funds.

*1. 50.44 Bitcoins: In Bankruptcy or Forfeiture Actions, Bitcoin Serves As “property”*

In one case, the federal government successfully argued to treat Bitcoin as property in a forfeiture action, however the judge’s ruling was notable for its discussion of the underlying criminal offense that permitted the forfeiture and its relationship with Bitcoin.<sup>120</sup> As discussed in *United States v. 50.44 Bitcoins*,<sup>121</sup> the relevant statute for forfeiture is 18 U.S.C. § 981, which states, “any property, real or personal, involved in a transaction or attempted transaction in violation of [18 U.S.C. § 1960], or any property traceable to such property” is “subject to forfeiture to the United States.”<sup>122</sup> Violation of 18 U.S.C. § 1960 occurs when persons “knowingly conduct, control, manage, supervise, direct, or own an unlicensed money transmitting business.”<sup>123</sup> An “unlicensed money transmitting business” is, among other things, a business that “fails to comply with the money transmitting business registration requirements under section 5330 of title 31, United States Code, or

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<sup>120</sup> *United States v. 50.44 Bitcoins*, No. CV ELH-15-3692, 2016 WL 3049166, at \*1 (D. Md. May 31, 2016).

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*; 18 U.S.C. § 981(a)(1)(A) (2016).

<sup>123</sup> 18 U.S.C. § 1960(a) (2006).

regulation prescribed under such section.”<sup>124</sup> After noting that FinCEN has issued rulings<sup>125</sup> that required an administrator or exchanger of bitcoin to register as a money service business with the agency in accordance with 31 U.S.C. § 5330, the court held that “a money transmitting business that operates in Bitcoins must register with FinCEN,” a “failure to register is a violation of 18 U.S.C. § 1960,” and “property involved in transactions that violate § 1960 is subject to forfeiture.”<sup>126</sup>

Thus, paradoxically, a business that transmits bitcoin is considered a “money” transmitter, presumably because the court found that bitcoin falls within the term “funds” in the § 1960 definition of “money transmitting,”<sup>127</sup> but the actual bitcoins in question are treated as merely property for the purposes of § 981 forfeiture. The court’s statutory interpretation here to hold that Bitcoin falls within the § 1960 definition of funds would be later used by other cases in order to bolster support for the argument that federal money-laundering statutes also apply to Bitcoin.

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<sup>124</sup> United States v. 50.44 Bitcoins, No. CV ELH-15-3692, 2016 WL 3049166, at \*1 (D. Md. May 31, 2016); 18 U.S.C. § 1960(b)(1)(B) (2016).

<sup>125</sup> See U.S. DEP’T OF THE TREASURY, FIN. CRIMES ENF’T NETWORK, FIN-2015-R001, APPLICATION OF FINCEN’S REGULATIONS TO PERSONS ISSUING PHYSICAL OR DIGITAL NEGOTIABLE CERTIFICATES OF OWNERSHIP OF PRECIOUS METALS (Aug. 14, 2013), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2015-R001.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2015-R001.pdf); DEP’T OF THE TREASURY, FIN. CRIMES ENF’T NETWORK, FIN-2014-R011, REQUEST FOR ADMINISTRATIVE RULING ON THE APPLICATION OF FINCEN’S REGULATIONS TO A VIRTUAL CURRENCY TRADING PLATFORM (Oct. 27, 2014), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2014-R011.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R011.pdf); U.S. DEP’T OF THE TREASURY, FIN. CRIMES ENF’T NETWORK, FIN-2014-R012, REQUEST FOR ADMINISTRATIVE RULING ON THE APPLICATION OF FINCEN’S REGULATIONS TO A VIRTUAL CURRENCY PAYMENT SYSTEM (Oct. 27, 2014), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/FIN-2014-R012.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R012.pdf).

<sup>126</sup> United States v. 50.44 Bitcoins, No. CV ELH-15-3692, 2016 WL 3049166, at \*1 (D. Md. May 31, 2016).

<sup>127</sup> “[T]he term ‘money transmitting’ includes transferring *funds* on behalf of the public by any and all means including but not limited to transfers within this country or to locations abroad by wire, check, draft, facsimile, or courier . . . .” 18 U.S.C. § 1960(b)(2) (2006) (emphasis added).

2. *Murgio: Bitcoin Is “Money” or “Funds” for Purposes of § 1960 Prosecution*

In the past several years a line of cases have taken the approach that Bitcoin qualifies as “funds” or “money” for the purposes of securities laws<sup>128</sup> and § 1960 prosecutions.<sup>129</sup> First, in denying the defendant’s motion to dismiss (which led to pleading guilty) in *United States v. Faiella*, the court defined “funds” in three different ways.<sup>130</sup> In using available dictionary definitions and the context of “funds” used within § 1960, the court held that “Bitcoin clearly qualifies as ‘money’ or ‘funds’ under these plain meaning definitions.”<sup>131</sup> For support, the judge cited the *Shavers* opinion that “Bitcoin can be easily purchased in exchange for ordinary currency, acts as a denominator of value, and is used to conduct financial transactions.”<sup>132</sup>

Following *Faiella*, the court in *United States v. Budovsky* explored prosecution of Bitcoin transactions through 31 U.S.C. § 5330 (Registration of Money Transmitting Business) and held that persons transacting in the sale of Bitcoins were considered a “money transmitter” under the statute’s language, because he or she transmits ‘currency, funds, or *other value that substitutes for currency*’ between persons or locations ‘by any means.’”<sup>133</sup> Most recently, in *United States v. Murgio*, the court acknowledged the reasoning in *Faiella* and *Budovsky*, and definitively stated that Bitcoins were subject to § 1960 prosecution because “dictionaries,

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<sup>128</sup> Sec. & Exch. Comm’n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, (E.D. Tex. Aug. 6, 2013), *adhered to on reconsideration*, No. 4:13-CV-416, 2014 WL 12622292 (E.D. Tex. Aug. 26, 2014).

<sup>129</sup> See *United States v. Faiella*, 39 F. Supp. 3d 544 (S.D.N.Y. 2014); *United States v. Budovsky*, No. 13CR368 DLC, 2015 WL 5602853, at \*1 (S.D.N.Y. Sept. 23, 2015); *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128 (S.D.N.Y. Sept. 19, 2016).

<sup>130</sup> *United States v. Faiella*, 39 F. Supp. 3d 544, 545 (S.D.N.Y. 2014).

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

<sup>132</sup> *Id.* at 545 (citing Sec. & Exch. Comm’n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, (E.D. Tex. Aug. 6, 2013)).

<sup>133</sup> See *United States v. Budovsky*, No. 13CR368 DLC, 2015 WL 5602853, at \*7 (S.D.N.Y. Sept. 23, 2015) (emphasis added) (citing the definition of “Money transmitter” in 31 C.F.R. § 1010.100(ff)(5)(i)(A)).

courts, and the statute's legislative history all point to the same conclusion: bitcoins are funds."<sup>134</sup>

### 3. *Petix*: Bitcoin Is Not "Money" or "Funds" for Purposes of § 1960 Prosecution

In 2016, the first known holding that Bitcoin was not "currency" or a "payment instrument," albeit only at the state level, meant that money laundering and money transmitting statutes could not be applied to Bitcoin.<sup>135</sup> The case revolved around whether the state criminal charges of acting as an unauthorized money transmitter and money laundering applied to a Bitcoin sale by the defendant.<sup>136</sup> Judge Pooler of the Circuit Court in the Eleventh Judicial Circuit in Miami-Dade County, Florida, held that Bitcoin does not fall under the state statutory definition of "currency" or "payment instrument," and should not be treated as a currency but rather treated as property.<sup>137</sup> Her ruling was the first judicial support for the IRS's treatment of Bitcoin as property for tax purposes.<sup>138</sup> While the judge minimized the significance of her holding—indeed her ruling at the trial level does not set precedent in state court or even within the same circuit—application of the IRS's stance in a tax setting to a state criminal proceeding is the first recorded state criminal application of this interpretation of Bitcoin and it was used to assert that state money-laundering statutes could not be applied to Bitcoin. This assertion was recently echoed in federal court in *United States v. Petix*.<sup>139</sup>

In *United States v. Petix*, the defendant engaged in numerous transactions involving the sale and purchase of bitcoin, some with

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<sup>134</sup> *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128, at \*4 (S.D.N.Y. Sept. 19, 2016).

<sup>135</sup> *State v. Espinoza*, No. F14-2923 (Fla. Cir. Ct. July 22, 2016) (unpublished decision), [http://www.miamiherald.com/latest-news/article91701087.ece/BINARY/Read%20the%20ruling%20\(PDF\)](http://www.miamiherald.com/latest-news/article91701087.ece/BINARY/Read%20the%20ruling%20(PDF)) (last visited Jan. 17, 2017).

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

<sup>137</sup> *Id.*

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

<sup>139</sup> *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919 (W.D.N.Y. Dec. 1, 2016).

an undercover agent, through the use of a computer.<sup>140</sup> Because Mr. Petix was on parole for child pornography charges, unreported use of a computer and accessing the Internet were violations of the conditions of his parole terms.<sup>141</sup> In addition to the parole violation charge, prosecutors sought to charge the defendant with operating an unlicensed money transmitting business in violation of 18 U.S.C. § 1960.<sup>142</sup> The judge dismissed the latter charge.<sup>143</sup> In conducting statutory interpretation of § 1960 and its terms, the judge found Bitcoin to be neither “funds” nor “money” as used and defined in § 1960 and other statutes because “across all legal authorities that make some reference to money, and despite new technologies that have emerged over the years within the United State monetary system, there has been a consistent understanding that money is not just any financial instrument or medium of exchange that people can devise on their own.”<sup>144</sup> Rather, what various accepted definitions of money have in common, the judge wrote, is “the involvement of a sovereign.”<sup>145</sup> This ruling created a split of authority with the aforementioned *Faiella* decision in the District Court for the Southern District of New York, but it is the latest holding that treats Bitcoin as a security or property and refuses to interpret it as “money” in order to apply the financial registration and regulation requirements.<sup>146</sup>

#### IV. THE ARGUMENT FOR BITCOIN’S REGULATION AS A SECURITY

While the topic of Bitcoin and its legal significance is certainly one that will continue, a clear and unified governmental

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<sup>140</sup> *Id.* at \*1.

<sup>141</sup> *Id.* at \*1.

<sup>142</sup> *Id.* at \*2.

<sup>143</sup> *Id.* at \*7.

<sup>144</sup> *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at \*4 (W.D.N.Y. Dec. 1, 2016).

<sup>145</sup> *Id.* at \*4.

<sup>146</sup> *See United States v. Faiella*, 39 F. Supp. 3d 544 (S.D.N.Y. 2014) (holding that Bitcoin falls within § 1960 regulation).

interpretation of Bitcoin as a security<sup>147</sup> will only aid in its maximum utilization and safety to the American public, and prevent unnecessary confusion and litigation. Although Bitcoin shares common qualities with currencies and commodities, it most mirrors the characteristics of a security. The best way to illustrate the benefit of treating Bitcoin as a security is to highlight the flaws in classifying Bitcoin as either a currency or a commodity.

*A. Bitcoin is Fundamentally Different From a Currency*

FinCEN defines currency as “the 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 the country of issuance.”<sup>148</sup> But Bitcoin is not coin or paper money, not designated legal tender by a country, and is not customarily used and accepted as a medium of exchange in any country, much less a non-existent “country of issuance.”<sup>149</sup> However, without gaining a full understanding of the technology or conferring with other important financial regulatory agencies and divisions, FinCEN attached new language to its statutory authority in a single public notice to allow the inclusion of Bitcoin and the application of § 1960 money-laundering offenses to Bitcoin transactions, in an apparent attempt to address *potential* concerns.<sup>150</sup>

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<sup>147</sup> A “commodity” definition would permit the IRS’s treatment of Bitcoin as “property,” and other market regulation entities to treat Bitcoin as a “good” whose value fluctuates like coal, orange juice, or gold.

<sup>148</sup> 31 CFR § 1010.100(m) (2016).

<sup>149</sup> See *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at \*4 (W.D.N.Y. Dec. 1, 2016).

<sup>150</sup> The FinCEN Director has publically stated that one of the animating purposes behind regulating virtual currency under a money-laundering regulatory regime is to “put effective anti-money-laundering and counter terrorist financing (“AML/CFT”) controls in place to [protect markets and financial institutions] from becoming the targets of illicit actors that would exploit any identified vulnerabilities.” Jennifer Shasky Calvery, *Remarks at Association of Certified Anti-Money Laundering Specialists (ACAMS) 19th Annual International AML and Financial Crime Conference* (Mar. 18, 2014), <https://www.fincen.gov/sites/default/files/2016-08/20140318.pdf>. Her boss, the

FinCEN's current policy contorts Bitcoin into a new category of virtual currency within its statutory regulation, without any justification other than a desire to prosecute more cases against those using Bitcoin. Regulation for regulation's sake is a bad recipe for addressing emerging technologies, especially when other federal agencies have already stepped in to provide measured guidelines for Bitcoin.<sup>151</sup>

*B. Bitcoin Does Not Fit Commodity Definition, Commodity Futures Are Merely An Instrument*

The Commodity Exchange Act defines a "commodity" as a number of listed goods "and all other goods and articles, . . . all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in."<sup>152</sup> The operative portion of the definition requires that the good be offered through a contract for future delivery. When bitcoins are purchased individually, whether over an exchange or through a person-to-person transaction, the bitcoins are received electronically and instantaneously. This does not in any way comport with the future delivery quality of commodities. Of course, any security futures contract or option could meet the operative requirement contained within the commodity definition,<sup>153</sup> but that says nothing of the underlying product, whether it is a security like a bitcoin or a commodity like coal.

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Under Secretary of Terrorism and Financial Intelligence, underscored the "illicit financial risks" that virtual currency poses as animating their regulatory approach. See David S. Cohen, *Remarks From Under Secretary of Terrorism and Financial Intelligence David S. Cohen on Addressing the "Illicit Finance Risks of Virtual Currency"* (Mar. 18, 2014), U.S. DEPARTMENT OF THE TREASURY, <https://www.treasury.gov/press-center/press-releases/Pages/jl236.aspx>.

<sup>151</sup> See *supra* Part III, Section A.

<sup>152</sup> 7 U.S.C. § 1a(9) (2016) (emphasis added). Examples of commodities include metals like gold or copper, energy sources like oil and gasoline, livestock like cattle or pork bellies, and agricultural products like cotton or sugar.

<sup>153</sup> *Id.*

The very fact that the CFTC Commissioner announced an explicit view that his agency has limited authority to regulate Bitcoin only when it is packaged within a futures contract or option is an encouraging signal.<sup>154</sup> The statement shows that CFTC leadership have educated themselves about the features and implications of Bitcoin, have considered other agency action pertaining to Bitcoin, and have concluded that their limited role regulating Bitcoin only applies in the futures context.<sup>155</sup> This speaks volumes about the true nature of Bitcoin and its rightful classification as a security.<sup>156</sup>

*C. Bitcoin Possesses the Functional Qualities of a Security As An “Investment Contract”*

The purchase of bitcoins is (1) an investment of money or thing of value (2) into a common enterprise, and (3) the purchaser is led to expect profits (4) solely from the efforts of a promoter or third party.<sup>157</sup> At the base of every transaction in Bitcoin is a decision to exchange some other value for possession of some amount of bitcoins with the expectation or hope that by holding it and exerting no personal effort it will increase in value and produce profit. The bitcoin represents a “share,” or unit of ownership in a financial asset, just like stock in a corporation.<sup>158</sup>

Perhaps the only scenario in which the obtaining of bitcoins is not a security is when it is obtained through mining.<sup>159</sup> Because the creation and possession of the bitcoins are the result of effort of the individual benefitting, the fourth *Howey* factor—requiring the profit to derive solely from the efforts of third parties—is not met.<sup>160</sup> A proper analogue to this is a capital investment in a partnership by one of the partners, where although the investor

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<sup>154</sup> See Pete Rizzo, *supra* note 113.

<sup>155</sup> See *id.*

<sup>156</sup> See *id.*

<sup>157</sup> See *S.E.C. v. W.J. Howey Co. et al*, 328 U.S. 293 (1946).

<sup>158</sup> See *Shares Definition*, INVESTOPEDIA, <http://www.investopedia.com/terms/s/shares.asp> (last visited Feb. 22, 2017).

<sup>159</sup> See L.S. *supra*, note 12.

<sup>160</sup> See *S.E.C. v. W.J. Howey Co. et al.*, 328 U.S. 293 (1946).

expects profits his efforts are involved in the creation of those profits. The equity produced from that partner's investment does not create a security under the "investment contract" definition that is used to capture non-traditional securities. However, beyond the straightforward tax implication of self-employment income, the mining method of bitcoin creation and possession is not among the activities that all the federal agencies seek to regulate.<sup>161</sup>

Furthermore, classification of Bitcoin as a security does not limit commodity futures regulation from applying when the Bitcoin is used within a futures contract, option, or derivative. Thus, treatment of Bitcoin as a security is consonant with the current IRS, SEC, and CFTC regulations. The chief concerns that Bitcoin can and will propagate fraud and money laundering can be addressed by the utilization of security exchange regulations applicable to Bitcoin already in existence, such as the Internal Revenue Code,<sup>162</sup> the Securities Act of 1933,<sup>163</sup> the Securities Exchange of 1934,<sup>164</sup> and the Commodities Exchange Act.<sup>165</sup>

### *1. Effective Internal Revenue Code Regulations Applicable to Bitcoin*

The Internal Revenue Code's regulations regarding general tax principles and the federal tax consequences that apply to transactions in property apply equally to Bitcoin.<sup>166</sup> A taxpayer

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<sup>161</sup> *I.R.S. Notice 2014-21*, IRS, <http://www.irs.gov/pub/irs-drop/n-14-21.pdf> (last visited Feb. 22, 2017).

<sup>162</sup> *See generally* 26 U.S.C. § 1 (2016). The Internal Revenue Code regulates, among other things, failing to provide tax information, which includes Form 1099-B submissions. *Id.*

<sup>163</sup> *See generally* 15 U.S.C. § 77 (2016). The Securities Act of 1933 regulates relevant areas such as fraud and failing to register as a broker or dealer. *Id.*

<sup>164</sup> 15 U.S.C. § 78 (2016) The Securities Exchange Act of 1934 is the most powerful securities regulation and covers relevant areas such as fraud and disclosure failures. *Id.*

<sup>165</sup> 7 U.S.C. § 1. The Commodities Exchange Act covers much of the same ground but focuses on commodities or futures contracts in financial instruments. *Id.*

<sup>166</sup> *See IRS Virtual Currency Guidance: Virtual Currency Is Treated as Property for U.S. Federal Tax Purposes; General Rules for Property Transactions Apply*, IRS, <https://www.irs.gov/uac/newsroom/irs-virtual->

who receives Bitcoin as payment for goods or services must include within the taxpayer's gross income the fair market value of the Bitcoin, measured in U.S. dollars, as of the date when received.<sup>167</sup> Wages paid to employees using virtual currency are taxable to the employee, must be reported by an employer on a Form W-2, and are subject to federal income tax withholding and payroll taxes.<sup>168</sup> Payments using virtual currency made to independent contractors or other service providers are taxable, and self-employment tax rules generally apply.<sup>169</sup> Typically those who pay either independent contractors or other service providers must issue Form 1099.<sup>170</sup> If the taxpayer holds the Bitcoin, then any gains and losses must be reported to the IRS.<sup>171</sup> A payment in Bitcoin in the course of a trade or business is subject to information reporting to the IRS to the same extent as any other payments in property.<sup>172</sup> Additionally, if a taxpayer's "mining" of virtual currency amounts to a trade or business, and the "mining" is not done as an employee for another, then the net earnings from that activity constitutes "self-employment" and is subject to the self-employment tax.<sup>173</sup>

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currency-guidance (last visited Feb. 23, 2017) [hereinafter Virtual Currency Guidance].

<sup>167</sup> I.R.S. Notice 2014-21, <http://www.irs.gov/pub/irs-drop/n-14-21.pdf> (last visited Feb. 22, 2017).

<sup>168</sup> See 26 U.S.C. § 3402; Virtual Currency Guidance *supra* note 166.

<sup>169</sup> See IRS, *supra* note 165.

<sup>170</sup> See *id.*

<sup>171</sup> See 26 U.S.C. §§ 1001-1111 (2016); Virtual Currency Guidance *supra* note 166.

<sup>172</sup> See Buntinx *supra*, note 23. Payments in property worth \$600 or more must be reported to the IRS. Therefore, any amount of Bitcoin worth \$600 or more that was exchanged as a payment of a debt or for a good or service must also be reported. See *id.*

<sup>173</sup> See 26 U.S.C. §§ 1401-1403 (2016); I.R.S. Notice 2014-21, IRS, <http://www.irs.gov/pub/irs-drop/n-14-21.pdf> (last visited Feb. 22, 2017); Chapter 10 of Publication 334, *Tax Guide for Small Business*, for more information on self-employment tax, <https://www.irs.gov/pub/irs-pdf/p334.pdf> (last visited Feb. 23, 2017).

## 2. *Effective Securities Regulations Applicable to Bitcoin*

The SEC regulations requiring that investors receive financial and other significant information concerning securities being offered for public sale . . . and [that] prohibit deceit, misrepresentations, and other fraud in the sale of securities” can readily be applied to Bitcoin both in primary and secondary markets.<sup>174</sup> Likewise, the Securities Exchange Act of 1934 and SEC Rule 10b-5 can also easily address any material misstatements, manipulative practices, or outright fraud perpetrated through the use of Bitcoin.<sup>175</sup>

## 3. *Effective Commodities Regulations Applicable to Bitcoin*

When Bitcoin is packaged as a futures contract or option for future delivery, the Bitcoin futures or option satisfies the definition of a commodity.<sup>176</sup> At that point the CFTC has concurrent jurisdiction over any investigation and regulation of both the futures product and the exchange that provides it.<sup>177</sup>

## D. *Summary of Benefits to Security Treatment of Bitcoin*

As shown by the available regulation and recent enforcement, the IRS, SEC, and CFTC are more than capable agencies that deal extensively with the regulation, monitoring, and enforcement of taxation and transactions in securities and commodities.<sup>178</sup> Each agency also has a significant capability to prosecute violations.<sup>179</sup>

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<sup>174</sup> See *supra* notes 74 and 75.

<sup>175</sup> 15 U.S.C. § 77–78 (2016); 17 C.F.R. 240.10b-5 (2016).

<sup>176</sup> See 7 U.S.C. § 1a(9) (2016).

<sup>177</sup> See *How Investigations Work*, U.S. SEC. & EXCH. COMM’N., <https://www.sec.gov/News/Article/Detail/Article/1356125787012> (last visited Jan. 29, 2017); *Enforcement*, U.S. COMMODITY FUTURES TRADING COMM’N., <http://www.cftc.gov/LawRegulation/Enforcement/index.htm> (last visited Jan. 29, 2017).

<sup>178</sup> See *supra*, Part III.

<sup>179</sup> See *Criminal Enforcement*, IRS, <https://www.irs.gov/uac/criminal-enforcement-1> (last visited Feb. 22, 2017); *How Investigations Work*, U.S. SEC. & EXCH. COMM’N., <https://www.sec.gov/News/Article/Detail/Article/1356125787012> (last visited Jan. 29, 2017); *Enforcement*, U.S. COMMODITY FUTURES TRADING COMM’N,

Consistent government agency treatment of Bitcoin as a security could give the public proper notice that, unlike American currency, the government does not financially back Bitcoin. The definitive non-currency treatment of Bitcoin would also inform the public that Bitcoin investments are not insured in the same way investments with a bank are insured. Currently, seven agencies<sup>180</sup> comport to this interpretation, while three agencies have treated Bitcoin as “money” or “funds.”<sup>181</sup>

It is apparent in its prosecutions<sup>182</sup> that the primary purpose agencies<sup>183</sup> and the government have had for treating Bitcoin as “money” or “funds” is to apply § 1960’s requirement to register as a money transmitting business to Bitcoin exchanges. However, the regulations by the IRS, SEC, and CFTC, already discussed above, provide the same level of market and exchange-level controls and monitoring to prevent fraud and market manipulation.<sup>184</sup>

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<http://www.cftc.gov/LawRegulation/Enforcement/index.htm> (last visited Jan. 29, 2017).

<sup>180</sup> Including sub-agencies, those that support defining Bitcoin as property or a security include the IRS, TIGTA, GAO, CFPB, SEC, FINRA, and CTFC.

<sup>181</sup> Including sub-agencies, those that have defined Bitcoin as “money” or “funds” include FinCEN, the IRS Criminal Investigation Division, and the Department of Justice.

<sup>182</sup> See generally *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128 (S.D.N.Y. Sept. 19, 2016); *United States v. Faiella*, 39 F. Supp. 3d 544 (S.D.N.Y. 2014); *United States v. Budovsky*, No. 13CR368 DLC, 2015 WL 5602853 (S.D.N.Y. Sept. 23, 2015); *SEC v. Shavers*, No. 4:13-cv-416, 2013 WL 4028182 (E.D. Tex. Aug. 6, 2013) (utilizing broad definitions of funds and money to include Bitcoin as within the financial registration requirements of § 1960).

<sup>183</sup> See generally U.S. DEP’T OF TREAS., FIN-2013-G001, APPLICATION OF FINCEN’S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES, (Mar. 18, 2013); Treasury Inspector General for Tax Administration, AS THE USE OF VIRTUAL CURRENCIES IN TAXABLE TRANSACTIONS BECOMES MORE COMMON, *Additional Actions Are Needed to Ensure Taxpayer Compliance* (Sept. 21, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630083fr.pdf>; *Hearing before the S. Comm. on Homeland Sec. and Governmental Affairs*, 113<sup>th</sup> Cong. (2013) (statement of Myhili Raman, acting Asst. Att’y Gen. of the United States, Criminal Division).

<sup>184</sup> See *supra*, Part III, Section A.

Furthermore, the individual-level regulation can be achieved by requiring all Bitcoin exchanges to provide recipients of Bitcoin Form 1099-B and by requiring both exchanges and individuals to report their purchases, sales, and gains to the IRS.<sup>185</sup> Form 1099-B is a simple form issued by an exchange or broker that summarizes all the proceeds of the subject transactions for an individual.<sup>186</sup>

By treating the purchase and sale of Bitcoin the same as any other share of stock or security, both the exchange and individual are required to report their gains and losses to the IRS when filing taxes each year.<sup>187</sup> A failure to do so by the exchange constitutes a failure to file correct informational returns and can result in a \$250 fine for every individual Form 1099-B not copied to the IRS, up to \$3 million total, or \$1 million for businesses that have gross receipts under \$5 million in a calendar year.<sup>188</sup> However, for certain cases of intentional disregard to file correct informational returns, the Internal Revenue Code provides that maximum fine limitation “shall not apply.”<sup>189</sup> Any intentional evasion of paying federal taxes also invokes criminal penalties of up to five years per offense.<sup>190</sup> The existing IRS, SEC, and CFTC regulations discussed above adequately meet the goals of deterrence and punishment, such that changing the definition of Bitcoin in order to reach federal money-laundering and money transmitter registration requirements is unnecessary and only serves to confuse the public and needlessly empower federal prosecutors.

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<sup>185</sup> See Chapter 16. Reporting Gains and Losses, *supra* note 42.

<sup>186</sup> See Form 1099-B, INVESTOPEDIA, <http://www.investopedia.com/terms/f/form-1099-b.asp> (last visited Jan. 29, 2017).

<sup>187</sup> See 26 U.S.C. §§ 1001-1111 (2013); Virtual Currency Guidance *supra* note 166.

<sup>188</sup> See 26 I.R.C. § 6721.

<sup>189</sup> See *id.* § 6721(e)(1) & (3).

<sup>190</sup> See 26 I.R.C. § 7202. *But see id.* § 7203 (listing one year imprisonment (per offense) as the penalty for failing to file an informational return).

## V. CONCLUSION

The application of security regulations benefits and protects the interests the government in three distinct ways. First, the government has an imperative interest in protecting the public from crime. Second, an understandable and enforceable regulatory framework already exists to enforce the law and protect the public if Bitcoin is treated as a security. Third, the security (and property) treatment of Bitcoin provides additional taxable revenue streams for the government to support, and oftentimes justify, its regulatory agency arms' existence.

Consistent security regulations will benefit all businesses that utilize Bitcoin by providing clearly communicated and understandable rules to follow. When businesses involve themselves in sometimes-risky investments, clearly defined rules can provide some minimum measure of predictability. In that regard, some amount of regulation is and has always been welcomed by developing industries, their investors, and the underlying consumers.

Additionally, consistent and clear regulation of Bitcoin as a security will benefit the public by deterring fraud and other crimes that otherwise would be facilitated by Bitcoin in the absence of those regulations. While ignorance of the law is never an excuse, increased accessibility and consistency of the law as it pertains to Bitcoin will serve as a more effective deterrent to those who believe that Bitcoin is ripe for criminal use.

Bitcoin does not possess the essential ingredients to be properly classified a recognized "currency." Its value and acceptance by vendors is not guaranteed by any government, nor is its value regulated by a sovereign. It is not insured by banks or other financial institutions and is not widely accepted. For those reasons, Bitcoin's value remains unstable, with volatile jumps and drops in value.<sup>191</sup> To stretch Bitcoin into a monetary regulatory

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<sup>191</sup> See *The Bitcoin Volatility Index*, BTCVOL.INFO, <https://btevol.info/> (last visited Mar. 14, 2017). Bitcoin's current thirty-day estimated volatility rate is 2.98%. For comparison, gold "averages around 1.2%," and major currencies "average between 0.5% to 1.0%." *Id.*

scheme is unnecessary because our government has effective regulatory controls in security transactions that recognize Bitcoin for what it is: an item of property, the value of which is determined by the individuals who buy, sell, and trade it. Whether Bitcoin thrives is not within our government's control. However, whether it can be effectively regulated in a way that deters and punishes crimes against the public through the use of Bitcoin has already been answered: the answer is yes.