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IRS, Will You Spare Some Change?: Defining Virtual Currency for the FATCA

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IRS, WILL YOU SPARE SOME CHANGE?: DEFINING VIRTUAL CURRENCY FOR THE FATCA

I. INTRODUCTION

The founding father commemorated on the one-dollar bill said, "[t]o be prepared for war is one of the most effectual means of preserving peace."[1] Although the quote relates to war, we adopt the underlying message as it relates to law. Arguably, creating law is the most effective means of resolving future legal disputes, especially issues that emerge when applying yesterday's law to the ever changing norms of today's society. Cryptocurrency, a type of electronic money, presents many legal issues as this new medium of currency has found its way into the world's economy.[2] Not to be confused with other digital currency, such as game awards or airline miles, cryptocurrency is not confined to a defined

1 George Washington, President, State of the Union Address (Jan. 8, 1790).

2 *See* CAL. DEP'T OF BUS. OVERSIGHT, WHAT YOU SHOULD KNOW ABOUT VIRTUAL CURRENCIES (2014), http://www.dbo.ca.gov/Consumers/Advisories/Virtual_Currencies_0414.pdf [http://perma.cc/2QTG-S482] (describing virtual currency as "encrypted, computer files that can be converted to or from a government-backed currency to purchase goods and services from merchants that accept virtual currencies"); KAN. OFFICE OF THE STATE BANK COMM'R, MT 2014-01, REGULATORY TREATMENT OF VIRTUAL CURRENCIES UNDER THE KANSAS MONEY TRANSMITTER ACT 1 (2014), http://www.osbckansas.org/mt/guidance/mt2014_01_virtual_currency.pdf [http://perma.cc/BV9H-JX9U] ("[V]irtual currency is an electronic medium of exchange typically used to purchase goods and services from certain merchants or to exchange for other currencies, either virtual or sovereign."). *See also* CONSUMER FIN. PROT. BUREAU, RISKS TO CONSUMERS POSED BY VIRTUAL CURRENCIES (2014), http://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf [http://perma.cc/PUX4-HG2M] (presenting reasons why consumers should be weary of using virtual currency); FIN. CRIMES ENFORCEMENT NETWORK, DEP'T OF THE TREASURY, FIN-2013-G001, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (2013), http://fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html [http://perma.cc/GYG2-BWVQ] (expressing that virtual currency has not reached legal status within any jurisdiction). The Consumer Financial Protection Bureau ("CFPB") posted a Consumer Advisory warning that this virtual currency attracts hackers, lacks protection from the government, can cost more to consumers, and is a vehicle for investment scams. CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 1–3. *See generally* Conference of St. Bank Supervisors, *Model State Consumer and Investor Guidance on Virtual Currency*, NASAA (Apr. 23, 2014), http://www.csbs.org/legislative/testimony/Documents/ModelConsumerGuidance--Virtual%20Currencies.pdf [http://perma.cc/72XE-FVER] (presenting the legal issues that the United States faces today related to virtual currency); Eur. Banking Auth., *Warning to Consumers on Virtual Currencies* 2–3 (Dec. 12, 2013), https://www.eba.europa.eu/documents/10180/598344/EBA+Warning+on+Virtual+Currencies.pdf [https://perma.cc/HAJ6-7GTD] (warning European consumers about the risks of virtual currency similar to the concerns listed in the CFPB advisory report).

market or business.[3] Instead, a variety of businesses and people accept it.[4] Even though the federal government implemented rudimentary regulations to protect consumers, it has yet to completely defend itself from potential tax abuse.[5]

Cryptocurrency transactions are fast, cheap, and moderately anonymous, triggering a two-fold reaction.[6] Buyers and sellers benefit because these transactions do not incur banking fees or credit card fees.[7] On the other hand, criminals use this virtual currency as a tool to facilitate illegal transactions, investment scams, and money laundering.[8]

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3 *See* N.Y. COMP. CODES R. & REGS. tit 23, § 200.2(p)(1)–(2) (2015) (excluding digital currencies "used solely within online gaming platforms" that "have no market or application outside of those gaming platforms" and digital currency "part of a customer affinity or rewards program with the issuer and/or other designated merchants"). Such currency cannot be redeemed for fiat currency. *Id*. *See also* Sarah Gruber, *Trust, Identity, and Disclosure: Are Bitcoin Exchanges the Next Virtual Havens for Money Laundering and Tax Evasion?*, 32 QUINNIPIAC L. REV. 135, 151–54 (2013) (listing different goods and services people can buy with Bitcoins).

4 *See* Gruber, *supra* note 3, at 151–52 (listing a numerous amount of goods that Bitcoins can buy such as gift cards, precious metals, jewels, cash, art, flowers, gun parts, books, lottery tickets, outdoor survival gear, computers, clothing, food, beauty products, and prescription drugs); *id.* at 153–54 (listing services that accept Bitcoins such as legal work, academic tutoring, music lessons, food delivery, taxi services, and charitable organizations).

5 *See infra* Part II.A.1 (presenting the IRS Notice which now adopts taxing virtual currency as property).

6 *See infra* Part II.A.1 (discussing the appeal of using virtual currency for pseudoanonymous criminal activity).

7 *See infra* Part II.A.1 (revealing the advantages to buyers and sellers).

8 *See* Tom Hays, *N.Y. Officials: Virtual Currency Invites Crime*, USA TODAY (Feb. 16, 2014), http://www.usatoday.com/story/money/business/2014/02/16/virtual-currency-invites-crime/5532287/ [http://perma.cc/6TPH-KER9] (noting the crimes that are facilitated with virtual currency). The most notable criminal venture is the Silk Road Exchange, which is a marketplace to obtain illegal drugs and weapons. *See* Emily Flitter, *FBI Shuts Alleged Online Drug Marketplace, Silk Road*, REUTERS (Oct. 2, 2013), http://www.reuters.com/article/2013/10/02/us-crime-silkroad-raid-idUSBRE9910TR20131002 [http://perma.cc/H9DY-LHGD] (reporting that "the Silk Road website has emerged as part of a darker side to the use of digital currencies"); *see also* David Kushner, *Dead End on Silk Road: Internet Crime Kingpin Ross Ulbricht's Big Fall*, ROLLING STONE (Feb. 4, 2014), http://www.rollingstone.com/culture/news/dead-end-on-silk-road-internet-crime-kingpin-ross-ulbrichts-big-fall-20140204 [http://perma.cc/8A26-U6FW] (publicizing the FBI's investigation efforts and the background of Ross Ulbricht, the administrator of the Silk Road). The Securities and Exchange Commission ("SEC") thoroughly addressed scamming in an Investor Alert. *See* OFFICE OF INVESTOR EDUCATION AND ADVOCACY, SEC. AND EXCH. COMM'N, SEC Pub. No. 153, PONZI SCHEMES USING VIRTUAL CURRENCIES (2013), http://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf [http://perma.cc/P8FH-3CLV] (revealing the recent investment scams involving virtual currency). The SEC warned Americans of certain signs that their investments may be a part of a Ponzi scheme. *Id.* The advisory report also informs investors that the Financial Crime Enforcement Network ("FinCEN") and the state equivalent require exchange sites and automated teller machines ("ATMs") to have licenses as money transmitters. *Id.* *See* CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 3 (reporting that using

Additionally, individuals use cryptocurrency as a weapon in evading state and federal taxes by converting their income into virtual currency and transferring the same to an offshore account.[9] Coupled with the existing struggle the United States faces against offshore tax evasion, cryptocurrency compounds the problem by adding barriers to help insulate assets from tax liability in the United States.[10]

Currently, the U.S. Government has no solution to prevent or restrict offshore tax evasion by using cryptocurrency.[11] Presently, offshore tax evasion is subdued under the Foreign Account Tax Compliance Act ("FATCA"), which requires foreign financial institutions to report the financial assets of American account holders to the Internal Revenue Service ("IRS").[12] However, the FATCA does not require virtual wallet providers, specialized storage service for cryptocurrency, to report American accounts or virtual wallets to the U.S. government as it does banks or credit unions.[13]

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exchange sites and ATMs may be more expensive than traditional payments); SEC, *Investor Alerts and Bulletin*, http://www.sec.gov/investor/alerts#.VLms4IuJnww [http://perma.cc/VMZ8-J7PJ] (explaining that the investor alerts are publications that the SEC issues to make investors aware of recent investment frauds or scams).

9 *See* Alison Bennett, *IRS Is Focusing Criminal Investigations On Use of Virtual Currency to Evade Taxes*, BLOOMBERG BNA (Oct. 3, 2014), [http://perma.cc/7WKZ-YKF5] (stating the IRS has the tools to trace the transactions, and the transactions are "far from anonymous"); Lauren French, *Bitcoin: Tax Haven of the Future*, POLITICO (Aug. 10, 2013), http://www.politico.com/story/2013/08/bitcoin-tax-haven-95420_Page2.html [http://perma.cc/CLK3-D36H] (remarking that there is no evidence that the FATCA caused Bitcoin to rise, but noting that tax evaders might turn to virtual currency to escape from the FATCA). *See generally* Gruber, *supra* note 3, at 140 (addressing possible tax haven issues with Bitcoin).

10 *See* Michael A. Berger, *Not So Safe Haven: Reducing Tax Evasion by Regulating Correspondent Banks Operating in the United States*, 12 J. INT'L BUS. & L. 51, 53 (2013) (describing tax havens). The article also states that tax havens are small and financially stable "countries that offer no or nominal tax rates to foreign investors . . . but [have] a high standard of living." *Id.*; *see also infra* Part II.D (discussing the FATCA, a tax system to combat tax evasion offshore).

11 *See* Bennett, *supra* note 9 (reporting that virtual currency is an instrument for tax evasion and inferring that the FATCA will have a role in its prevention).

12 *See infra* Part II.B (elaborating that Congress implemented the FATCA to reduce offshore tax evasion); *see also* Stephen Saporta, *Tax Shelter Registration: An Alternative Proposal That Leads to the Efficient Identification of Abusive Tax Shelters*, 20 VAL. U. L. REV. 489, 489–90 (1986) (analyzing the Deficit Reduction Act of 1984, which requires registration with the IRS in an effort to reduce tax shelters).

13 *See* Bennett, *supra* note 9 (addressing the uncertainty of whether financial institutions will report U.S. accounts); Drew Singer, *The Bitcoin Boom: A Currency for Tax Evasion*, LAW360 (Jan. 29, 2014), http://www.law360.com/articles/503437/the-bitcoin-boom-a-currency-for-tax-evasion [http://perma.cc/N3RK-M8PL] (inferring that Bitcoin is not regulated by FATCA and is ideal for tax evasion); Li Zhou, *What is Bitcoin, Exactly?*, SMITHSONIAN (Jan. 27, 2015), http://www.smithsonianmag.com/innovation/what-is-bitcoin-exactly-

Therefore, the IRS should define cryptocurrency as being subject to the FATCA restrictions to avoid tax evasion using offshore virtual wallet providers.[14] This Note proposes that cryptocurrencies, virtual wallets, and virtual wallet providers should be defined as foreign financial assets, foreign financial accounts, and foreign financial institutions, respectively.[15] First, Part II provides information about the virtual economy by illustrating the intentions behind creating the virtual market, laws currently directing the virtual market, and a historical context of the FATCA.[16] Next, Part III offers an analysis of the FATCA's control over the virtual economy and proposes adding key definitions to the FATCA agreements by contracting with foreign virtual wallet providers to report the virtual currencies back to the IRS.[17] Finally, Part IV concludes that reporting cryptocurrency under the FATCA is feasible and that these changes will reduce tax evasion by supplying the government with complete and accurate financial records of U.S. persons' accounts.[18]

II. BACKGROUND

The recent implementation of the FATCA has started to cease offshore tax evasion in traditional foreign financial systems.[19] However, the FATCA fails to address the recent evolution of the virtual financial system

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180954033/?no-ist [http://perma.cc/Q2E9-ZDDD] (describing the virtual currency system as "a new way of doing what banks have been doing"). Bennett acknowledges that:

> [I]t remains unclear whether intermediaries and exchanges created to handle virtual currency will be treated as foreign financial institutions required to tell the IRS about U.S.-owned accounts under the Foreign Account Tax Compliance Act. Panelist, Andrew J. Keyso, IRS Associate Chief Counsel (Income Tax & Accounting), said the commission doesn't have a published position yet but is aware of the issue. The IRS Office of Associate Chief Counsel (International) is studying this question, and "FATCA guidance continues to evolve . . . ."

Bennett, *supra* note 9.

14 *See infra* Part IV (proposing language to be added to the FATCA agreements, which will make cryptocurrency reportable to the IRS).

15 *See infra* Part III (concluding that virtual wallet providers, virtual wallets, and virtual currency can be foreign financial institutions, foreign financial accounts, and foreign financial assets).

16 *See infra* Part II (elaborating on the characteristics of virtual currency, virtual wallets, virtual wallet providers, and the FATCA).

17 *See infra* Part III.B (analyzing the law and characteristics presented in Part II to argue that the FATCA agreements can include virtual currency, virtual wallets, and virtual wallet providers); *infra* Part IV (proposing the language that should be used in the agreements and explaining the importance of the chosen language).

18 *See infra* Part IV (concluding that the government should make these changes to further their goal of preventing tax evasion).

19 *See infra* Part II.C (discussing how the FATCA reduces offshore tax evasion by requiring banks and other financial institutions to report assets to the IRS).

that exists today.[20] To understand how the FATCA can require foreign wallet providers to report cryptocurrencies, the reader must understand the nature of the virtual economy and functions of the FATCA.[21] First, Part II.A discusses the elements of the virtual market: virtual currency; virtual wallets; and virtual wallet providers.[22] Next, Part II.B discusses court precedent and regulations guiding the virtual market.[23] Then, Part II.C presents the components of the FATCA by providing insight to the considerations behind the legislation, defining its terms, and addressing the praise and criticism.[24] Finally, Part II.D reveals that scholars and professionals are unable to agree whether or not the virtual market is included in the FATCA.[25]

A. The Virtual Market

The virtual market is comprised of cryptocurrency (virtual currency), virtual wallets, and virtual wallet providers.[26] The demand for the virtual market was first recorded in 1998 by Wei Dai who "envisioned a system which 'untraceable pseudonymous entities' . . . [could] cooperate with each other more efficiently, by providing them with a medium of exchange and a method of enforcing contracts."[27] This virtual economy sought to avoid the need for government interference because the transactions are pseudonymous and once complete, cannot be undone.[28]

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[20] *See infra* Part II.C (noting that the IRS chose not to publish an opinion of whether virtual currency will be reported under the FATCA).

[21] *See infra* Part II (presenting information regarding the virtual market and the FATCA).

[22] *See infra* Part II.A (explaining the characteristics of virtual markets).

[23] *See infra* Part II.B (examining government concerns and case law dealing with issues regarding virtual currency).

[24] *See infra* Part II.C.1 (overviewing the FATCA's history); *infra* Part II.C.2–5 (reviewing the aspect of the FATCA, such as "foreign financial institutions," "non-financial foreign institutions," the exemptions and exclusions to "foreign financial institutions" and "foreign financial accounts."); *see also* Part II.C.6 (noting the consequences so far and expected results of the FATCA).

[25] *See infra* Part II.D (reviewing the different opinions of scholars and professionals).

[26] *See* Perianne Boring, *Bitcoin Basics for the "76 Percenters" Who Don't Have a Clue What It Is*, FORBES (Feb. 22, 2014), http://www.forbes.com/sites/perianneboring/2014/02/22/bitcoin-basics-for-the-76-percenters-who-dont-have-a-clue-what-it-is/ [http://perma.cc/9UMU-4R9Y] (explaining that one needs to get a virtual wallet, from a wallet provider, before getting virtual currency).

[27] Nicholas A. Plassaras, *Regulating Digital Currencies: Bringing Bitcoin Within the Reach of IMF*, 14 CHI. J. INT'L L. 377, 383 (2013).

[28] *See* Nikolei M. Kaplanov, *Nerdy Money: Bitcoin, The Private Digital Currency, and The Case Against Its Regulation*, 25 LOY. CONSUMER L. REV. 111, 114–15 (2012) (highlighting the timeline of how the virtual market was developed). Kaplanov states:

> In 1998, Wei Dai, a member of the Cypherpunks electronic mailing list, sought to avoid the need for an intermediary in an electronic payment transaction by proposing the concept of an anonymous digital

In 2009, Satoshi Nakamoto supplied the virtual market demand and created the world's first cryptocurrency, the "Bitcoin."[29] Since its genesis, "anarchists" have introduced over thirty currencies to the virtual economy.[30] First, Part II.A.1 reveals how entities define virtual currency, how "miners" develop it, and how users exchange it.[31] Next, Part II.A.2 provides the types of virtual wallets and virtual wallet providers.[32]

1. Virtual Currency

"'[V]irtual currency' is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of [fiat] currency."[33] Cryptocurrency is a type of "decentralized virtual currency" meaning that it is not issued by an administrator.[34] Instead,

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> currency . . . . His idea was to create a currency where government involvement "is not temporarily destroyed but permanently forbidden and permanently unnecessary."

Id.

29 *See* Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN, https://bitcoin.org/bitcoin.pdf [https://perma.cc/6XBF-FQHZ] (documenting information about the Bitcoin system). Satoshi Nakamoto is a pseudonym. *See Who is Satoshi Nakamoto?*, COINDESK (Jan. 2, 2015), http://www.coindesk.com/information/who-is-satoshi-nakamoto/ [http://perma.cc/4Y9U-LXMV] (acknowledging that the identity of Satoshi Nakamoto is unknown and noting names of people suspected of being Nakamoto).

30 *See* Prableen Bajpai, *The 5 Most Important Virtual Currencies Other Than Bitcoin*, INVESTOPEDIA (Dec. 10, 2014), http://www.investopedia.com/articles/investing/121014/5-most-important-virtual-currencies-other-bitcoin.asp [http://perma.cc/W8F8-Z63F] (naming five other major virtual currencies that are popular); Reuven Cohen, *The Top 30 Crypto-Currency Market Capitalizations In One Place,* FORBES (Nov. 27, 2013), http://www.forbes.com/sites/reuvencohen/2013/11/27/the-top-30-crypto-currency-market-capitalizations-in-one-place/ [https://perma.cc/G2VW-DU3F] (listing the number of virtual currencies that exist as of November 2013).

31 *See infra* Part II.A.1 (defining virtual currency by giving examples of its scope, explaining how one can get virtual currency and how the transaction process works, and examining the criticism by the government and the current IRS regulations). Miners are people who run programs on their computers to earn virtual currency. *See* Alex Castle, *Beginner's Guide to Mining Litecoin, Dogecoin, and Other Bitcoin Variants*, PC WORLD (May 6, 2014), http://www.pcworld.com/article/2151261/beginners-guide-to-mining-litecoin-dogecoin-and-other-bitcoin-variants.html [http://perma.cc/YV5Q-27QP] (persuading readers to consider mining virtual currencies other than Bitcoin).

32 *See infra* Part II.A.2 (reporting the different kinds of virtual wallets and virtual wallet holders).

33 FIN. CRIMES ENFORCEMENT NETWORK, *supra* note 2, at 1. *See also supra* note 2 and accompanying text (noting different definitions of virtual currency).

34 *See* KAN. OFFICE OF THE STATE BANK COMM'R, *supra* note 2, at 1 (identifying the two types of virtual currencies as centralized and decentralized). Centralized virtual currency is generally administered by private parties, usually companies, in the form of game earnings or airline miles. *Id.* *See* N.Y. COMP. CODES R. & REGS. tit 23, § 200.2(p)(1)(2) (2015) (excluding digital currencies used in online gaming platforms or a part of a customer affinity/rewards program). Specific markets contain centralized virtual currency, which is not a concern for

cryptocurrencies like Bitcoin, Litecoin, and Peercoin are maintained by a network of computers.[35]

Cryptocurrency prides itself on the security, efficiency, and freedom from third party involvement from the government, banks, or credit card companies.[36] Consumers like cryptocurrency because transactions are pseudoanonymously cloaked, quick, and cheap.[37] Sellers of goods and

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offshore tax evasion. *See* David J. Mack, *iTax: An Analysis of the Laws and Policies Behind the Taxation of Property Transactions in a Virtual World*, 60 ADMIN. L. R. 749, 750 (2008) (discussing taxing video game virtual currency); Jordan McKee, *Redefining Virtual Currency*, YANKEE GROUP (May 2013), http://home.tapjoy.com/info/wp-content/uploads/sites/4/2013/05/RedefiningVirtualCurrency_WhitePaper-1MAY2013-v1.pdf [http://perma.cc/4PE5-S9GH] (presenting history of how virtual currencies became prominent in today's society when the first coupon was introduced and when credit cards started rewarding users); Andrew Wagner, *Digital vs. Virtual Currencies*, BITCOIN MAG. (Aug. 22, 2014), https://bitcoinmagazine.com/15862/digital-vs-virtual-currencies/ [https://perma.cc/29T7-RPM6] (distinguishing between digital and virtual currencies). Wagner argues that "virtual currency" is a term that does not include Bitcoin or other cryptocurrencies, but rather the currency provided by games. Wagner, *supra* note 34; *see infra* Part II.A (describing how decentralized virtual currency is camouflaged by computer programs so that transaction are not intercepted). However, because the state and federal government uses the term "virtual currency" to describe Bitcoins and other similar currencies, this Note uses the term. *See supra* note 2 and accompanying text (noting that State and Federal Agencies use the term "virtual currency" to describe cryptocurrencies); *see also* Cameron Graham, *Study: Why Customers Participate in Loyalty Programs*, TECH. ADVICE (July 23, 2014), http://technologyadvice.com/gamification/blog/why-customers-participate-loyalty-programs/ [http://perma.cc/4JG4-633P] (illustrating that consumers these days use digital currency in the form of coffee rewards, airline miles, and in store money back rewards).

35 *See* KAN. OFFICE OF THE STATE BANK COMM'R, *supra* note 2, at 2 (revealing that peer-to-peer networks, not one person, support decentralized virtual currencies); *see also* PAUL VIGNA & MICHAEL J. CASEY, THE AGE OF CRYPTOCURRENCY 9 (St. Martin's Press 2015) ("[D]escribes a fundamental set of programming instructions that allow computers to communicate with each other. Bitcoin's protocol is run over a network of computers that belong to the many people around the world that are charged with maintaining its core *blockchain* ledger and monetary system."); Cohen, *supra* note 30 (listing additional well-known virtual currencies); Wagner, *supra* note 34 (distinguishing decentralized currency from centralized currency); Mark Ward, *How to Mint Your Own Virtual Money*, BBC NEWS (Apr. 25, 2014), http://www.bbc.com/news/technology-27143341 [http://perma.cc/G6G2-PXC9] (telling his personal experience creating a new virtual currency).

36 *See* Kaplanov, *supra* note 28, at 116 (discussing characteristics of online transactions); VIGNA & CASEY, *supra* note 35, at 5 (identifying that cryptocurrencies eliminate "middlemen and their fees").

37 *See* Jacob Davidson, *New York Proposes Bitcoin Regulations*, TIME (July 18, 2014), http://time.com/money/3004751/new-york-bitcoin-regulations-benjamin-lawsky/ [http://perma.cc/JVT-76TH] (discerning why consumers would prefer using virtual currency); *see also* Bennett, *supra* note 9 (stating that the IRS can find identities of those in virtual exchanges); Alan Yu, *How Virtual Currency Could Make it Easier to Move Money*, NPR (Jan. 15, 2014), http://www.npr.org/blogs/alltechconsidered/2014/01/13/262179539/how-virtual-currency-could-make-it-easier-to-move-money [http://perma.cc/U2CC-WP26] (asserting virtual currency is globally accepted, and users avoid transfer fees of currency between banks); Josh Zerlan, *Buying Something Illegal? Bitcoin Is Not the Currency*

services benefit from accepting cryptocurrency because they save a percentage of their gross income that is normally paid to credit card companies.[38] Each unit of currency has no intrinsic value, but instead is worth what people are willing to trade for it.[39] As a consequence, the average price fluctuates as people exchange the currency at different prices.[40]

To use cryptocurrency, a holder must acquire at least two linked addresses: the public address receives units and the private address permits access to spend units.[41] Virtual currency is not a digital file or

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for You, SC MAG. (July 3, 2014), http://www.scmagazine.com/buying-something-illegal-bitcoin-is-not-the-currency-for-you/article/358585/ [http://perma.cc/KQF8-H84Q] (cautioning that Bitcoin is not truly an anonymous transaction).

[38] *See* Kim LaChance Shandrow, *5 Reasons Merchants Should Start Accepting Bitcoin Now*, ENTREPRENEUR (Sept. 4, 2014), http://www.entrepreneur.com/article/237026 [http://perma.cc/BEZ5-XJA8] (noting that vendors would benefit from using virtual currency).

[39] *See* Philipp Brockington, Book Note, 8 VAL. U. L. REV. 715, 716 (1974) (reviewing THE NOMINALISTIC PRINCIPLE, ELIYAHU HIRSCHBERG (1971)) ("A unit of currency is always equal to itself, a pound is equal to a pound, a dollar is always equal to a dollar . . . ."); Joe Weisenthal, *Here's the Answer to Paul Krugman's Difficult Question About Bitcoin*, BUS. INSIDER (Dec. 30, 2013), http://www.businessinsider.com/why-bitcoin-has-value-2013-12 [http://perma.cc/4E5X-QP6B] (articulating how virtual currency has value).

[40] *See* Jesse Colombo, *Bitcoin May Be Following This Classic Bubble Stages Chart*, FORBES (Dec. 19, 2013), http://www.forbes.com/sites/jessecolombo/2013/12/19/bitcoin-may-be-following-this-classic-bubble-stages-chart/ [http://perma.cc/G3CL-UXG6] (analyzing the rise and fall of Bitcoin prices); CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 3 ("In 2013, Bitcoin's price fell as much as 61% in a single day. In 2014, the one-day price drop has been as big as 80%."); Fin. Indus. Regulatory Auth., *Bitcoin: More than a Bit Risky* (May 7, 2014), http://www.finra.org/investors/protectyourself/investoralerts/fraudsandscams/p45645 8 [http://perma.cc/5FHG-BXRQ] (noting that the price fluctuates often); Ryan W. Neal, *Bitcoin Bubble Burst? An Insider's Explanation for the Currency's Fluctuating Value*, INT'L BUS. TIMES (Apr. 10, 2013), http://www.ibtimes.com/bitcoin-bubble-burst-insiders-explanation-currencys-fluctuating-value-1184481 [http://perma.cc/3GG4-GEVY] (illuminating that Bitcoin's popularity with merchants and citizens, in countries in economic crisis, as well as investors, makes the price fluctuate); N. Am. Sec. Adm'r Ass'n, *Top Investor Threats*, http://www.nasaa.org/3752/top-investor-threats/ [http://perma.cc/45UV-6LH2] (warning investors of virtual currency's instability).

[41] *See How do Bitcoin Transactions Work?*, COINDESK (Mar. 6, 2014), http://www.coindesk.com/information/how-do-bitcoin-transactions-work/ [http://perma.cc/Q8NZ-BCYJ] (analogizing the addresses as a "safe deposit box with a glass front"). *See also Cryptographic Services*, MICROSOFT DEVELOPER NETWORK, http://msdn.microsoft.com/en-us/library/92f9ye3s(v=vs110).aspx [http://perma.cc/RW2D-3TYX] (elaborating on the encryption process). This source explains that:

> Public-key encryption uses a private key that must be kept secret from unauthorized users and a public key that can be made public to anyone. The public key and the private key are mathematically linked; data that is encrypted with the public key can be decrypted only with the private key, and data that is signed with the private key can be verified only

document, but a record of value.[42] Address holders can increase the value in their addresses through mining or exchanging for fiat currency.[43] Mining is the process of running software that computes an encryption function and awards virtual units to whoever solves a complex algorithm.[44] Mining is accessible to anyone willing to run a program on a computer.[45] However, mining is a difficult process that requires multiple computers or users to find an unclaimed value.[46] As it pertains to increasing one's wealth of cryptocurrency, it is easier and faster to purchase cryptocurrency from miners, designated automated teller

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> with the public key. The public key can be made available to anyone; it is used for encrypting data to be sent to the keeper of the private key.

Id.

42 *See* VIGNA & CASEY, *supra* note 35, at 124 ("Bitcoins do not constitute documents or other digital files. The balance you see in your wallet is simply a net value of spending power based on an accounting of the incoming and outgoing transactions."). *See also How do Bitcoin Transactions Work?*, *supra* note 41 (explaining that virtual currencies do not exist as a file). The article states:

> Here's the funny thing about bitcoins: they don't exist anywhere, even on a hard drive. We talk about someone having bitcoins, but when you look at a particular bitcoin address, there are no digital bitcoins held in it, in the same way that you might hold pounds or dollars in a bank account. You cannot point to a physical object, or even a digital file, and say "this is a bitcoin."

Id.; *see also* Anthony Effinger, *Coinbase Leads Move to Bring Bitcoin to Masses*, BLOOMBERG (Sept. 30, 2014), http://www.bloomberg.com/news/2014-09-30/coinbase-leads-move-to-bring-bitcoin-to-masses.html [http://perma.cc/JR8S-HFLD] (recognizing the limited supply of Bitcoins); Rob Wile, *What Is Litecoin: Here's What You Need to Know About the Digital Currency Growing Faster than Bitcoin*, BUS. INSIDER (Nov. 27, 2013), http://www.businessinsider.com/introduction-to-litecoin-2013-11 [http://perma.cc/6XLQ-YQ7R] (commenting on Litecoin's supply limitations).

43 *See How Can I Buy Bitcoins?*, COINDESK (Nov. 26, 2014), http://www.coindesk.com/information/how-can-i-buy-bitcoins/ [http://perma.cc/9TJD-SLSY] (clarifying how someone can receive bitcoins by mining or purchasing from transaction websites).

44 *See* Andy Greenberg, *Crypto Currency*, FORBES (Apr. 20, 2011), http://www.forbes.com/forbes/2011/0509/technology-psilocybin-bitcoins-gavin-andresen-crypto-currency.html [http://perma.cc/P68N-M69F] (exposing that miners who run the network receive value for sharing their resources); *see also Mining Digital Gold*, THE ECONOMIST (Apr. 13, 2013), http://www.economist.com/news/finance-and-economics/21576149-even-if-it-crashes-bitcoin-may-make-dent-financial-world-mining-digital [http://perma.cc/6QDT-D7UV] (noting that users are rewarded virtual currency after their computers solve mathematical algorithms).

45 *See* Castle, *supra* note 31 (providing guidance to anyone who is interested in mining virtual currency).

46 *See* Kaplanov, *supra* note 28, at 119–20 (explaining the mining process); Morgen E. Peck, *The Bitcoin Arms Race Is On!*, IEEE SPECTRUM (May 6, 2013), http://spectrum.ieee.org/computing/networks/the-bitcoin-arms-race-is-on [http://perma.cc/E48E-CSYK] (discussing whether mining is worth the time and money).

machines ("ATMs"), or online exchange sites, than mining for virtual currency on one's computer.[47]

To transfer virtual currency, a sender must go to an exchange site or a wallet service provider.[48] The sender adds the receiver's public address to a transaction message and specifies how many units are being transferred.[49] When the transfer is complete, part of the sender's public address is tethered to the virtual unit so the network recognizes that

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[47] *See* Chris Gayomali, *Want to Make Money off Bitcoin Mining? Hint: Don't Mine*, THE WEEK (Apr. 15, 2013), http://theweek.com/articles/465541/want-make-money-bitcoin-mining-hint-dont-mine [http://perma.cc/LVQ5-2XK2] (discouraging people from mining because the process is expensive and arduous); Rick Jervis, *Bitcoin ATMs Come to USA*, USA TODAY (Feb. 20, 2014), http://www.usatoday.com/story/money/business/2014/02/19/bitcoin-atm-austin/5623387/ [http://perma.cc/VNW7-6ZGF] (announcing the availability of Bitcoin ATMs in the United States); *see also Bitcoin ATM Map*, COINDESK, http://www.coindesk.com/bitcoin-atm-map/ [http://perma.cc/8XBP-L8XY] (displaying all the locations of Bitcoin ATMs). According to the CFPB, consumers could be paying more with virtual currencies than other payment options. CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 1. The report indicates that some "ATMs" are not actual ATMs, and the Bitcoin ATMs raise the price more than the exchange rate plus service fees. *Id.* at 3. The report implies that because the rate changes so frequently, the price you received it at and the price you exchanged it at will likely be different, which could lead to over payment. *Id. See* Eur. Banking Auth., *supra* note 2, at 2 (warning that virtual currencies lack security, which can lead to someone losing their money, someone stealing the virtual currency, and someone having the value of their virtual currency reduce to nothing); *What Is the Difference Between Litecoin and Bitcoin?*, COINDESK (Apr. 2, 2014), http://www.coindesk.com/information/comparing-litecoin-bitcoin/ [http://perma.cc/3ZH9-KNCQ] (contrasting the transaction process between Bitcoin and Litecoin).

[48] *See How to Sell Bitcoin*, COINDESK (Oct. 23, 2015), http://www.coindesk.com/information/sell-bitcoin/ [http://perma.cc/9KRG-BQGG] (establishing that selling bitcoins online requires going to websites such as Coinbase, LocalBitcoins, or "exchange trades," which are virtual-exchange sites).

[49] *See* VIGNA & CASEY, *supra* note 35, at 125 (confirming that one must know their public address to transfer virtual currency to someone else). "You would then type in the desired payment amount and hit 'Send,' thereby instructing the wallet software to find a sufficient bitcoin balance . . . and send that balance . . . ." *Id. See Cryptographic Services*, *supra* note 41 (noting the difficulty of deciphering third party interceptions).

address as no longer holding value.[50] In addition, the network records all transaction on the public ledger called a "blockchain."[51]

2. Virtual Wallets and Virtual Wallet Providers

After establishing public and private addresses, users secure the addresses with a "virtual wallet."[52] Virtual wallets take the form of paper, electronic hardware—such as desktop or external memory source, and online service.[53] Paper virtual wallets display both public and private addresses as a quick response code.[54] Similar to paper money, this form is exposed to risk of damage, theft, or loss.[55] Virtual wallets taking the form of electronic hardware storage provides the user more security than the paper alternative.[56] When the hardware storage is subject to damage

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50 *See* Patrick McLeod, *Taxing and Regulating Bitcoin: The Government's Game of Catch Up*, 22 COMMLAW CONSPECTUS 379, 382–83 (2014) (expanding on how transactions are completed); *Cryptographic Services*, *supra* note 41 (exposing how consumers send currency to the intended receiver); Thomas Lowenthal, *Bitcoin: Inside the Encrypted, Peer-to-Peer Digital Currency*, ARSTECHNICA (June 8, 2011), http://arstechnica.com/tech-policy/2011/06/bitcoin-inside-the-encrypted-peer-to-peer-currency/ [http://perma.cc/ZDA9-SFH3] ("Whenever you spend a Bitcoin, you cryptographically sign a statement saying that you have transferred the coin to a new owner and you identify the new owner by their public crypto key."); Nakamoto, *supra* note 29, at 2 ("Each owner transfers the coin to the next by digitally signing a hash of the previous transaction and the public key of the next owner and adding these to the end of the coin."); Barrett Sheridan, *Bitcoins: Currency of the Geeks*, BLOOMBERG BUSINESSWEEK (June 16, 2011), http://www.businessweek.com/magazine/content/11_26/b42340415548 73.htm [http://perma.cc/H3BN-MZXQ] (elaborating on how the network verifies that the buyer owns the currency he is trying to exchange); *see also How Bitcoin Mining Works?*, COINDESK (Dec. 22, 2014), http://www.coindesk.com/information/how-bitcoin-mining-works/ [http://perma.cc/9J4L-ZUD8] (elaborating on the process of how people can mine for virtual currencies).

51 *See* Sheridan, *supra* note 50 (reporting that public ledgers list transactions).

52 *See How to Store Your Bitcoins*, COINDESK (Dec. 22, 2014), http://www.coindesk.com/information/how-to-store-your-bitcoins/ [http://perma.cc/2XGY-VU28] (explaining that "wallets store the private keys that you need to access" the values for spending).

53 *See id*. (elaborating about the types of wallets: desktop wallets, mobile wallets, online wallets, hardware wallets, and paper wallets); *see also* Peter Hardy & Mehreen Zaman, *Evaders May Turn to Virtual Currency as Traditional Offshore Bank Secrecy Falters*, BLOOMBERG BNA 4 (Apr. 18, 2004), http://www.bna.com/troubling-ninth-circuit-p17179890229/ [http://perma.cc/67UA-VD5Z] (describing each wallets' advantages and disadvantages).

54 *See* Hardy & Zaman, *supra* note 53, at 4 (listing the benefits and disadvantages of all the possible ways to keep virtual currency); *How to Make a Paper Bitcoin Wallet*, COINDESK, http://www.coindesk.com/information/paper-wallet-tutorial/ [http://perma.cc/GAX4-SSP4] (endorsing paper wallets as the safest way to "store" Bitcoin and shows viewers how to create quick response "QR" codes that links to the addresses).

55 *See* Hardy & Zaman, *supra* note 53, at 4 (warning that paper wallets are fragile forms subject to damage and theft); *see also How to Make a Paper Bitcoin Wallet*, *supra* note 54 (cautioning that paper wallets are easily damaged).

56 *See* Hollie Slade, *Nymi Unveils Heartwave-Sensing Wristband to Keep Your Bitcoin Safe*, FORBES (Feb. 4, 2014), http://www.forbes.com/sites/hollieslade/2014/02/04/nymi-

or theft, the access to the virtual currency is also stolen or damaged.[57] Online services in the form of phone applications provide portability and convenience, but the private addresses are known to another party that can facilitate transactions and exchanges.[58]

Furthermore, online virtual wallets are another third party source that stores the information online with a multitude of other holders.[59] By using the Internet to secure information, some providers are platforms for exchange between virtual and fiat currency.[60] There are various online wallet service providers across the globe.[61] Some providers link wallet forms; for example, online and phone application or online and desktop.[62] The provider issues addresses to the users and some withhold the capability to transfer funds on the user's behalf.[63] These providers are

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unveils-heartwave-sensing-wristband-to-keep-your-bitcoin-safe/ [http://perma.cc/N5XE-VJBZ] (revealing that this device recognizes the user's heart rhythm to unlock the device and allow spending). *See also How Is TREZOR Different From . . . an Ordinary Web Wallet?*, SATOSHILABS, http://doc.satoshilabs.com/trezor-faq/differences.html [http://perma.cc/J738-NLTA] (comparing Trezor device to other wallets). Trezor claims to be more secure than online, desktop, and phone wallets. *Id.*

57 *See* Hardy & Zaman, *supra* note 53, at 4 (discussing that hardware incurs disadvantages, such as damage and theft).

58 *See How to Store Your Bitcoins*, *supra* note 52 (warning that although online wallet providers can be accessed anywhere, the provider is "in charge of your private keys"); *see also How do Bitcoin Transactions Work?*, *supra* note 41 (revealing that if anyone knows the private address, they are capable of stealing the virtual currency).

59 *See* PEDRO FRANCO, UNDERSTANDING BITCOIN CRYPTOGRAPHY, ENGINEERING, AND ECONOMICS 131 (2015) (naming external online based wallets as wallet service providers); *How to Store Your Bitcoins*, *supra* note 52 (noting that online wallet providers, such as Coinbase, Circle, Blockchain, Strongcoin and Xapo, have access to private addresses and can be accessed anywhere).

60 *See How Can I Buy Bitcoins?*, *supra* note 43 ("Some are full-blown exchanges for trades between paper fiat currencies and multiple other digital currencies, while others are simpler wallet services with a more limited range of trading options. Many will store amounts of digital and/or fiat currency for you, much like a regular bank account.").

61 *See About*, COINKITE (2015), https://coinkite.com/faq/about [https://perma.cc/H3FU-498Z] (declaring itself as a Canadian provider); BITCOIN TREZOR, https://www.bitcointrezor.com [http://perma.cc/R43Q-E9LX] (highlighting that its parent company, SatoshiLabs, is located in Prague, Czech Republic); *Q&A*, QUOINEXCHANGE, https://www.quoine.com/faq/#/faq19 [https://perma.cc/6FPP-AYK8] (excluding service from seven countries but providing bank deposits in Japan, Singapore, and Indonesia); *About Us*, BITSTAMP, https://www.bitstamp.net/about_us/ [https://perma.cc/Q93M-PP2C] (identifying itself as located in the United Kingdom, Luxembourg, and the United States).

62 *See How to Store Your Bitcoins*, *supra* note 52 (presenting the types of wallets: paper, hardware, online, phone applications, etc.); *FAQ*, ARMORY (2015), https://bitcoinarmory.com/faq/ [https://perma.cc/M4T9-AQ45] (linking desktop and online virtual wallets); *How Does it Work?*, HIVE, http://hivewallet.com [http://perma.cc/ZH7F-9GR5] (providing access to a virtual wallet through the internet and phone application).

63 *See What Payment Methods to Offer Your Shoppers?*, ABOUT PAYMENTS, https://www.about-payments.com/knowledge-base/methods [https://perma.cc/BHD6-

easily exposed to theft by hackers because providers do not enjoy the same insurance as banks.[64] Most providers charge a percentage of the amount in the account or charge part of an exchange, but there are some providers that offer services for free.[65]

B. *Today's Law Concerning Virtual Currency*

Due to its recent emergence in today's society, there are few American laws that address virtual currency.[66] Consequently, courts have little

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SYC8] (revealing that when one registers for a virtual online wallet, the provider assigns the user with addresses); *Choose Your Bitcoin Wallet*, BITCOIN, https://bitcoin.org/en/choose-your-wallet [https://perma.cc/P95G-8DA2] (listing wallet providers that control addresses and therefore means users need to trust the company).

64 *See Securing Your Wallet*, BITCOIN, https://bitcoinorg/en/secure-your-wallet [https://perma.cc/E485-VC3V] (noting that online backup should be encrypted to reduce vulnerability to theft). The Mt. Gox affair is the most recent example of how virtual currency accounts are prey for hackers. *See* CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 5 (highlighting that $400 million disappeared and Mt. Gox's customers have not recovered any funds). Unlike "real currency" in a bank, the Federal Deposit Insurance Corporation does not insure virtual currency and virtual wallets. *See id.* at 4 (noting that the government will not protect funds in a virtual currency account); Cameron Keng, *Bitcoin Must Create a Community-Backed FDIC*, FORBES (Mar. 20, 2014), http://www.forbes.com/sites/cameronkeng/2014/03/20/bitcoin-must-create-a-community-backed-fdic/ [http://perma.cc/R9JF-TWTB] (proposing that Bitcoin community should insure Bitcoin, which would result in the stabilization).

65 *See Fee Schedule*, BITSTAMP, https://wwwbitstampnet/fee_schedule/ [https://perma.cc/574K-CMLK] (charging clients monthly based on amount in their accounts); *Fee Structure*, QUOINE, https://www.quoine.com/fees/ [https://perma.cc/HX93-NW2F] (charging bitcoin receivers); *My Wallet: Be Your Own Bank*, BLOCKCHAIN.INFO, https://blockchaininfo/wallet [https://perma.cc/XGN8-Q55J] (establishing that the wallet is free).

66 *See infra* Part II.B.1–2 (presenting court opinions and regulations that are currently governing the virtual market); *see also* Eur. Banking Auth., *EBA Opinion on "Virtual Currency"* 5 (July 4, 2014), http://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf [http://perma.cc/3XPU-3YQP] [hereinafter *EBA Opinion*] (warning that virtual currencies are not regulated and therefore risks associated do not have relief). The European Bank Authority advised "national supervisory authorities to discourage credit institutions, payment institutions and e-money institutions from buying, holding or selling [virtual currencies]." *See EBA Opinion*, *supra* note 66, at 6. The financial institutions that provide an account for its clients in the future, would make it subject to the FATCA. *See* Reuben Grinberg, *Bitcoin: An Innovative Alternative Digital Currency*, 4 HASTINGS SCI. & TECH. L.J. 159, 161–62 (2012) (discounting that current laws can regulate the virtual market); Bailey Reutzel, *French Company's Move Gives Regulators a Window on Bitcoin*, PAYMENTSOURCE (Dec. 11, 2012), http://www.paymentssourcecom/news/french-companys-move-gives-regulators-a-window-on-bitcoin-3012598-1.html [http://perma.cc/E7Z7-VATR] ("Bitcoin-Central, a French digital currency exchange that handles the largely unregulated Bitcoin currency, now operates under French regulation after parent-company Paymium partnered with payment services provider Aqoba."); *see also* Jacob Farber et al., *Virtual Currencies: International Actions and Regulations*, JDSUPRA (Sept. 12, 2014), http://www.jdsupra.com/legalnews/virtual-currencies-international-action-03024/

statutory laws or precedent to guide their opinions when confronted with issues revolving around the virtual market.[67] Consequently, courts are forced to adapt the tangential law to virtual issues.[68] Some government agencies have taken steps to regulate small portions of the virtual market within their jurisdiction.[69] First, Part II.B.1 reviews court interpretations of virtual currency.[70] Then, Part II.B.2 examines Financial Crimes Enforcement Network ("FinCEN") and IRS regulations.[71]

1. Court Opinions Shaping Laws Around Virtual Currency

Courts recognize that virtual currencies are similar to official money.[72] In *SEC v. Shavers*, the Third Circuit held that virtual currency is similar to fiat currency.[73] Trendon Shavers invited lenders to invest in a Bitcoin investment opportunity.[74] The SEC contended that Mr. Shavers made misrepresentations and defrauded the investors.[75] The question before

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[http://perma.cc/TY5H-F7VH] (compiling a chart of international regulations and actions regarding virtual currencies); Global Legal Research Ctr., *Regulation of Bitcoins in Selected Jurisdictions*, THE LAW LIBRARY OF CONG. 1–24 (Jan. 2014), http://www.loc.gov/law/help/bitcoin-survey/regulation-of-bitcoin.pdf [http://perma.cc/5QVM-DKXW] (reporting regulations of Bitcoin, if any, in forty-one jurisdictions of the world including China, Canada, Brazil, and Greece).

67 *See infra* Part II.B.2 (looking at FinCEN and IRS regulations of the virtual market).

68 *See infra* Part II.B.1 (reviewing the court opinions of *SEC v. Shavers* and *United States v. Faeilla*).

69 *See infra* Part II.B.1 (observing that the court opinions of *Shavers* and *Faeilla* tailor the laws to apply to the virtual market).

70 *See infra* Part II.B.2 (noting the FinCEN and IRS regulations guiding the virtual market).

71 *See infra* Part II.B.2 (examining the regulations of the FinCEN and IRS).

72 *See* United States v. Ulbricht, 31 F. Supp. 3d 540, 548 (S.D.N.Y 2014) ("Bitcoins carry value—that is their purpose and function—and act as a medium of exchange. Bitcoins may be exchanged for legal tender, be it U.S. dollars, Euros, or some other currency."); Bob Adelmann, *Federal Court Rules that the Bitcoin Is Money*, THE NEWAMERICAN (Aug. 9, 2013), http://www.thenewamerican.com/economy/markets/item/16256-federal-court-rules-that-the-bitcoin-is-money [http://perma.cc/8ND9-6MY6] (commenting on the ruling of *SEC v. Shavers* by saying Bitcoin is money); Tanaya Macheel, *4 Court Cases Helping Determine US Stance on Bitcoin*, COINDESK (Sept. 28, 2014), http://www.coindesk.com/4-court-cases-helping-determine-us-stance-bitcoin/ [http://perma.cc/6TYD-75RN] (discussing past and pending court cases, such as *United States. v. Faeilla*, *SEC v. Shavers*, *State of Florida v. Espinoza*, and *United States v. Ulbricht*).

73 SEC v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex. Aug. 6, 2013). Fiat currencies are currencies that are administered by a government and the government determines the value regardless of whether it is backed by gold or another commodity. *See Fiat*, A DICTIONARY OF AMERICANISMS ON HISTORICAL PRINCIPLES (Mitford M. Mathews ed., 1951) (defining "Fiat" as "[e]stablished or made valid by government fiat or legislative enactment").

74 *Shavers*, 2013 WL 4028182, at *1.

75 *Id.*

the court was whether the investments were securities.[76] The court analyzed a statute from the United States Code stating that a security is "any note, stock, treasury stock, security future, security-based swap, bond . . . [or] investment contract . . . ."[77] The court defined "investment contract" as "any contract, transaction, or scheme involving (1) an investment of money, (2) in a common enterprise, (3) with the expectation that profits will be derived from the efforts of the promoter or a third party."[78] The court stated:

> It is clear that Bitcoin can be used as money. It can be used to purchase goods or services, and as Shavers stated, used to pay for individual living expenses. The only limitation of Bitcoin is that it is limited to those places that accept it as currency. However, it can also be exchanged for conventional currencies, such as the U.S. dollar, Euro, Yen, and Yuan. Therefore, Bitcoin is a currency or form of money, and investors wishing to invest in [Mr. Shaver's investing company] provided an investment of money.[79]

Ultimately, the court held Shaver's business met the definition for investments contracts, and therefore was subject to the SEC's jurisdiction.[80]

In *United States v. Faiella*, the court analyzed 18 U.S.C. § 1960, which states that money transmitters must be licensed with the Department of Treasury.[81] The United States charged Mr. Faiella with operating an

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76 *Id.*

77 *Id.* at *2; *see also* 15 U.S.C. § 77b(a)(1) (2012) (providing a definition of a security for purposes of the Securities Act of 1933).

78 *Shavers*, 2013 WL 4028182, at *2; *see* SEC v. W.J. Howey & Co., 328 U.S. 293, 298–99 (1946) (issuing the test to determine if the investments were investment contracts).

79 *Shavers*, 2013 WL 4028182, at *2.

80 *Id.*; *see also* SEC v. Shavers and Bitcoin Savings and Trust, Litigation Release No. 23090, 2014 WL 4702601 (Sept. 22, 2014) (reiterating the results of the case and presenting the remedies the court determined).

81 United States v. Faiella, 39 F. Supp. 3d 544, 546 (S.D.N.Y. 2014); *see* 18 U.S.C. § 1960(b)(1)(A) (2012) (requiring money transmitting businesses to register with the state). Congress enacted this section to prosecute those conducting a money transmitting business without a state license where states required it, as a federal crime. *See* Stefan D. Cassella, *Application of 18 U.S.C. § 1960 to Informal Money Service Businesses*, SELECTEDWORKS 1 (Sept. 2003), http://works.bepress.com/cgi/viewcontent.cgi?article=1010&context=stefan_cassella [http://perma.cc/U4EB-RHRE] (reporting that Congress enacted 31 U.S.C. § 5330, which required that all money transmitting businesses register with the Secretary of Treasury).

unlicensed money transmitting business.[82] Mr. Faiella asked to dismiss the case because "Bitcoin does not qualify as 'money' under section 1960."[83] The court found that the statute did not limit money to "officially coined or stamped metal currency" or paper currency.[84] As a result, Bitcoin qualified as "money" or "funds."[85]

2. Administrations Regulating Virtual Systems in Financial Matters

The FinCEN is a bureau of the Department of Treasury that combats money laundering ploys and conspiring financial institutions.[86] FinCEN issued a guidance clarifying that an administrator or exchanger of virtual currency is a "money service business" ("MSB") or "a money transmitter," which makes them subject to FinCEN's authority through the Bank Secrecy Act.[87] As such, it falls under the definition of "financial institution."[88]

The IRS recognized cryptocurrency as a source of income and responded by posting Notice 2014-21, which treats virtual currency as

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82 *Faiella*, 39 F. Supp. 3d at 545.

83 *Id.*

84 *See id.* (finding that the statute referred to funds). The court used Merriam-Webster Online in its reasoning, which defines funds as "an amount of something that is available for use: a supply of something." *Id.* The court also looked at the legislative intent and recognized that this statute supported the finding because "Congress was concerned that drug dealers would turn increasingly to 'nonbank financial institutions' to 'convert street currency into monetary instruments' in order to transmit the proceeds of their drug sales." *Id.* at 545–46.

85 *See id.* ("[I]t is likely that Congress designed the statute to keep pace with such evolving threats . . . .").

86 *See generally What We Do*, FINCEN, http://www.fincen.gov/about_fincen/wwd/ [http://perma.cc/QZ66-ZS3C] (elaborating on FinCEN's authority over the financial market).

87 *See* FIN. CRIMES ENFORCEMENT NETWORK, *supra* note 2, at 1 (analyzing that FinCEN interprets "money transmitter" to be "money service business" and therefore the Bank Secrecy Act regulations apply). An exception states that a user involved in the sale of goods and services is not a money service business. *Id.* at 2; *see also Faiella*, 39 F. Supp. 3d at 546–47 (using this reasoning to determine whether the website "Silk Road" was a money transmitting business). A money transmitter business is "any person" that accepts "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 . . . by any means. . . ." 31 C.F.R. § 1010.100(ff)(5)(i)(A) (2015). The terms "any means" includes: "through a financial agency or institution; a Federal Reserve Bank or other facility of one or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both; an electronic funds transfer network; or an informal value transfer system; or [a]ny other person engaged in the transfer of funds." *Id.* § 1010.100(ff)(5)(i)(A)–(B).

88 *See* 31 C.F.R. § 1010.100(t)(3) (2015) (establishing that a money services business is a type of financial institution).

taxable property.[89] As taxable property, it is subject to a capital gains or loss tax.[90] A capital gains or loss tax is determined after accounting for profits or expenses.[91]

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89 *See* I.R.S. Notice 2014-21, 2014-16 I.R.B. 938–39 (Apr. 14, 2014), https://www.irs.gov/pub/irs-irbs/irb14-16.pdf [https://perma.cc/L5WX-CF2A] [hereinafter IRS Notice] (reporting that virtual currency will have a capital gains and loss tax). "For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency." *Id*. at 938. *See* 26 U.S.C. § 61(a) (allowing taxation of "all income from whatever source derived"). The treasury regulation's section 1.61-1(a) defines gross income as "income realized in any form, whether in money, property, or services." 26 C.F.R. § 1.61-1(a) (2015). These laws allow the IRS to tax cryptocurrency. Mack, *supra* note 34, at 757 (noting that virtual currency can be taxed under current law). He states:

> While there has been no attempt to require tax payments resulting from virtual activity, such regulation does not appear to be outside the scope of the IRS's authority under its enabling legislation. Because the tax code defines income broadly enough to encompass any source of income, the IRS would not exceed its rulemaking authority by promulgating additional regulations specifically governing virtual economies.

Id. at 757 n.50; *see* Paul Caron, *Marian: Bitcoin and Notice 2014–21*, TAXPROF BLOG (Mar. 26, 2014), http://taxprof.typepad.com/taxprof_blog/2014/03/marian-bitcoin.html [http://perma.cc/X5T5-EQJZ] (supporting the IRS by saying "the IRS guidance is an effective one [because i]t is clear, concise, and correct on the law"). *But see Stockman Plans to Introduce the "Virtual Currency Tax Reform Act"*, UNITED STATES REPRESENTATIVE STEVE STOCKMAN (Apr. 8, 2014), http://stockmanhousegov/media-center/press-releases/stockman-plans-to-introduce-the-virtual-currency-tax-reform-act [http://perma.cc/32HZ-U3LS] (disagreeing with the IRS Notice, Representative Stockman proposes that virtual currency should be redefined as foreign currency).

90 *See Tax-Capital Gains Tax*, BLACK'S LAW DICTIONARY (10th ed. 2014) [hereinafter Capital-Gains Tax Definition] ("A tax on income derived from the sale of a capital asset."); IRS Notice, *supra* note 89, at 938–39 (publishing an opinion declaring that the IRS will tax virtual currency based on capital gains or losses); *see also* William D. Lewis, *Why the IRS Is Wrong on the Taxation of Bitcoin Mining*, GLOBAL L. & BUS. PERSPECTIVE (Mar. 27, 2014), http://www.glbperspective.com/tax-law/why-the-irs-is-wrong-on-the-taxation-of-bitcoin-mining/ [http://perma.cc/RTN3-8ASD] ("[T]he IRS has taken the position that a person who mines virtual currency is being paid in virtual currency for the service of mining virtual currency, rather than the person has produced virtual currency, a piece of property, through capital intensive number crunching.").

91 *See* Capital-Gains Tax Definition, *supra* note 90 (defining a capital-gains tax). *See also* Richard Rubin & Carter Dougherty, *Bitcoin Is Property Not Currency in Tax System, IRS Says*, BLOOMBERG BUSINESS (Mar. 25, 2014), http://www.bloomberg.com/news/articles/2014-03-25/bitcoin-is-property-not-currency-in-tax-system-irs-says [http://perma.cc/4244-YLWF] (providing an example of buying coffee with a Bitcoin and the tax implications of that purchase for both the consumer and seller).

C. The Foreign Account Tax Compliance Act

Tax evasion through the use of offshore accounts reduces the federal tax revenue by at least $40 billion every year.[92] The United States' tax system is voluntary but lacks compliance, which is one policy reason Congress enacted the FATCA.[93] Between 2008 and 2010, the FBI and IRS informed President Obama and Congress of the high degree of tax evasion and tax avoidance.[94] In response, Congress and the President passed the

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92 *See Problems at the Internal Revenue Service: Closing the Tax Gap and Preventing Identity Theft: Hearing Before the Subcomm. on Gov't Org., Efficiency, and Fin. Mgmt. of the Comm. On Oversight and Gov't Reform. U.S. H. of Representatives*, 112th Cong. 55 (2012) (statement of J. Russell George, Treasury Inspector General for Tax Administration) (estimating that the difference of revenue to be between $40 million and $123 million per year); John T. VanDenburgh, *Closing International Loopholes: Changing the Corporate Tax Base to Effectively Combat Tax Avoidance*, 47 VAL. U. L. REV. 313, 314–15 (2012) (noting that tax avoidance strategies also decrease United States' revenue); Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply than to Opt Out*, 39 J. CORP. L. 155, 157 (2013) (discussing that tax evasion reduces the tax revenue).

93 *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (statement of Sen. Levin) (reiterating that the tax evasion concern is regarding assets held in foreign institutions). The FATCA is the popular name for Title V of the Hiring Incentives to Restore Employment Act ("HIRE") enacted during March 2010. ROSS MCGILL, U.S. WITHHOLDING TAX: PRACTICAL IMPLICATIONS OF QI AND FATCA 4 (Michael C. S. Wong et al. ed., 2013); *see also* Frederic Behrens, Comment, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 WIS. L. REV. 205, 211 (2013) (noting that the system for taxation has been based upon a voluntary assessment and payment). *See generally* Hiring Incentives to Restore Employ. Act, 26 U.S.C. §§ 1471–74 (2012); Information with Respect to Foreign Financial Assets, 26 U.S.C. § 6038D (2010) (providing the language of the FATCA and the date of enactment).

94 *See Tax Haven Abuses: The Enablers, the Tools and Secrecy – Vol. 1 of 4: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Homeland Sec. and Governmental Affairs*, 109th Cong. 166 (2006) (statement of Sen. Levin and Sen. Coleman) (noting that foreign financial institutions harbor trillions of dollars in assets); Stephen A. Nauheim et al., *Portfolio 6565 – 1st: FATCA – Information Reporting and Withholding Under Chapter 4*, BNA at Part I.C (2015), http://taxandaccounting.bna.com/btac/display/split_display.adp?eid=18714312,18718381&cid=0&vname=fipporitax&sd=18718381&just_clicked=18718381&clicked_level=2&split=0#18718381 [http://perma.cc/L6G7-YWZK] [hereinafter Portfolio 6565] (noting that in 2006 committees started discussing how to combat offshore tax evasion). In 2008, the same committees held hearings and prepared reports on Tax Haven Banks and U.S. Tax Compliance, and the Senate Finance Committee discusses the Cayman Islands and offshore tax issues. Portfolio 6565, *supra* note 94, at Part I.C. In 2009, the House Ways and Means Committee held a hearing on offshore tax evasion. *Id.* Throughout the inquiry, the IRS, Justice Department, and FBI investigated foreign banks, such as USB, HSBC, and Deutsche bank to see if they were helping Americans evade taxes. *Id.* at n.27. Investigators found that the Swiss bank, USB, helped Americans evade taxes, but agreed to pay $780 million in fines and provide client names as part of the settlement. David S. Hilzentrath & Zachary A. Goldfarb, *UBS to Pay $780 Million over U.S. Tax Charges,* WASH. POST (Feb. 19, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/02/18/AR2009021802541.html [https://perma.cc/7JWC-GFDH]. The FATCA is similar to its predecessor, the Qualified Intermediary scheme, which was implemented in 2000. Melissa A. Dizdarevic, Comment, *The FATCA Provisions of the HIRE Act: Boldly Going Where No Withholding Has Gone*

FATCA "to prevent, deter, detect[,] and correct" Americans from evading United States' taxes with offshore accounts.[95] The FATCA does not replace other efforts to cease offshore tax evasion, but is an additional tool to restrain such acts.[96]

First, Part II.C.1 discusses the purpose, functions, and agreements of the FATCA.[97] Second, Part II.C.2 describes the foreign financial institutions, non-financial foreign institutions, and exemptions.[98] Then, Part II.C.3 elaborates on the law regarding foreign financial accounts and financial assets.[99] Last, Part II.C.4 presents criticism that the FATCA received.[100]

1. Purposes, Consequences, and Agreements

The most significant provision of the FATCA is chapter four of the Internal Revenue Code.[101] The new chapter requires foreign financial

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Before, 79 FORDHAM L. REV. 2967, 2978 (2011). This scheme asked foreign financial institutions to voluntarily agree to withhold and report tax on subjected income in exchange for certain benefits. *Id.* at 2978–79. However, the program was less effective because financial institutions had less restrictions. *Id.* at 2979–80.

95 MCGILL, *supra* note 93, at 108. *See id.* at 114 (noting Americans evade taxes by putting their money into foreign bank or brokerage accounts held by foreign institutions that "could be depository . . . or a securities account containing equities, bonds or other financial instruments").

96 *See generally* Portfolio 6565, *supra* note 94, at Part I.D (discussing other tools in place to help reduce tax evasion, such as the Report of Foreign and Financial Accounts ("FBAR"), the Trade Reporting and Compliance Engine ("TRACE"), the EU Savings Directive, the EU Third AML Directive, the Financial Action Task Force, the OECD Report on Base Erosion and Profit Shifting ("BEPS"), the Multilateral Tax Information Exchange Agreements, the OECD Common Reporting Standard).

97 *See infra* Part II.C.1 (presenting the history and motive behind FATCA).

98 *See infra* Part II.C.2 (describing foreign financial institutions, non-financial foreign institutions, and circumstances when the IRS would exclude these institutions).

99 *See infra* Part II.C.3 (exposing statute and case law that review foreign financial accounts).

100 *See infra* Part II.C.4 (reflecting on opinions of the FATCA).

101 *See* Portfolio 6565, *supra* note 94, at Part I.B (noting that the biggest change was in Chapter four). *See also* MCGILL, *supra* note 93, at 5 (stating that Chapter three and Chapter four definitions of "financial institution" varies to include banks, brokerage firms, and a wide variety of other institutions). McGill stated that:

> [T]he IRS has changed the definition of "financial institution" and also that of "financial account." In the regulations, the definition of an [foreign financial institution] is very clear, but it contains a widening of what most people would determine to be financial institution. This has major implications because, from a practical viewpoint, those firms that were traditional financial institutions prior to 1 January 2013, banks, brokers, etc. already have many of the policies, procedures and systems that are the foundation for compliance for FATCA.

Id. at 117.

institutions to identify U.S. account holders and report information back to the IRS to prevent gross discrepancies between what the account holders reported and what the financial institutions reported.[102] Furthermore, the FATCA requires foreign entities that are not financial institutions to provide information regarding ownership to withholding agents, including any U.S. owners holding an interest greater than ten percent in a foreign entity.[103] If neither the non-financial foreign entity or foreign financial entity comply with the FATCA reporting requirements, they are faced with a "[thirty percent] withholding tax on payments to them of certain categories of [United States] source fixed or determinable annual or periodical ("FDAP") income, as well as on gross proceeds from the sale or other disposition of debt to equity interests in [United States] issuers."[104]

The United States drafted two types of agreements: intergovernmental and foreign financial institution agreements.[105] The first model of intergovernmental agreements entails reciprocal reporting between the United States and a foreign government, which requires financial institutions to report to their parent governments before the IRS

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[102] *See generally* Hiring Incentives to Restore Employ. Act, 26 U.S.C. § 1471(c)(1)(A)–(D) (2010) (requiring "foreign financial institutions to report" information to the IRS); *see also* Portfolio 6565, *supra* note 94, at Part I.B (summarizing that the FATCA requires foreign financial institutions to report the foreign financial assets of Americans); Berger, *supra* note 10, at 74 (clarifying that the FATCA "places more pressure on the foreign financial institutions to disclose pertinent information to the IRS").

[103] *See* Portfolio 6565, *supra* note 94, at Part II.B (noting that non-financial foreign institutions are required to report the accounts of U.S. persons).

[104] *Id. See also* Behrens, *supra* note 93, at 213–14 (noting that the FATCA is not deemed voluntary because non-complying foreign financial institutions will have thirty percent withholdings); Lynnely Browning, *Complying With U.S. Tax Evasion Law Is Vexing Foreign Banks*, N.Y. TIMES (Sept. 16, 2013), http://dealbook.nytimes.com/2013/09/16/complying-with-u-s-tax-evasion-law-is-vexing-foreign-banks/?_r=0 [http://perma.cc/4J62-PSSK] (characterizing the FATCA as "bullying and selfish"); Raymond Grove, *The Cost of Getting Caught: Taxpayer Penalties for FATCA*, CONVEY (Dec. 26, 2013), http://www.convey.com/1099-news-tax-blog/tax-tips/the-cost-of-getting-caught-taxpayer-penalties-for-fatca/ [http://perma.cc/37CJ-3JQ8] (portraying that financial institutions are sanctioned for not reporting under FATCA, and individuals who do not report their foreign assets are sanctioned under FBAR).

[105] *See generally* DEP'T OF TREASURY, RESOURCE CENTER: FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA), http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx#ModelAgreements [http://perma.cc/XYS7-AY4H] (providing model intergovernmental agreements); Thomas Humphreys et al., *No Waiting – FFIs Should Act Now to Prepare for FATCA*, INT'L TAX REV. 17 (Sept. 1, 2012), http://media.mofo.com/files/Uploads/Images/120913-ITR-No-Waiting-Prepare-for-FATCA.pdf [http://perma.cc/E68U-GH72] (elaborating on different agreements with Japan and Switzerland).

receives the information.[106] The second model requires foreign financial institutions to privately sign an agreement with the IRS and directly report to the IRS.[107] Upon entering the second model agreement, the institution must obtain waivers from the governing country to disregard the foreign privacy laws that may conflict with the FATCA reporting requirements, or close the account.[108]

The conditions of both agreements require the foreign financial institution to obtain general information regarding their account holders

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106 *See* Brian Christiansen et al., *FATCA Finally Takes Effect, Subject to Transition Rules*, JDSUPRA (Feb. 9, 2015), http://www.jdsupra.com/legalnews/fatca-finally-takes-effect-subject-to-70759/ [http://perma.cc/X3JD-54VP] (describing that intergovernmental agreements require that foreign financial institutions report to the local government, which is later reported to the IRS); *FATCA: Two Model IGAs*, ARTHURBELLCPAS, http://www.arthurbellcpas.com/difference-between-the-two-model-igas [http://perma.cc/749A-URQE] (explaining the two models of agreements: one that requires foreign financial institutions to report to the foreign government without signing an agreement with the IRS and another that requires foreign financial institutions to enter agreement with IRS privately).

107 *See* Philip R. Hirschfeld, *FATCA 2013 Overview: Getting Down to the Wire*, 27 J. TAX'N & REG. FIN. INSTS. 59, 60 (2014) ("On August 19, 2013, the IRS opened its long awaited electronic FATCA Registration Website, which serves as the primary way for [foreign financial institutions] to interact with the IRS."); Stephen Nauheim & Nils Cousin, *The Evolving FATCA Guidance*, 42 TAX MGMT. INT'L J. 183, 183 (2013) (evaluating the preparation for the FATCA to be fully implemented). Hirschfeld notes that:

> Once accepted, registration will make the [foreign financial institution] a party to the standardized [foreign financial institution] [a]greement so that it can become a [participating foreign financial institution] or in some cases, act as an acknowledgement that the [foreign financial institution] is deemed compliant. A [foreign financial institution] that registers on the Website will, upon approval, receive a Global Intermediary Identification Number (GIIN), which will be used both for reporting purposes and to identity the [foreign financial institution]'s status to U.S. withholding . . . taxes under FATCA.

Hirschfeld, *supra* note 107, at 60.

108 *See* 26 U.S.C. § 1471(b)(1)(F) (2012) (noting that if a foreign government does not waive the foreign privacy laws conflicting with the FATCA reporting, then the institution must close the account). *See generally* Paul M. Schmidt & Michael W. Nydegger, *FATCA Intergovernmental Agreements—Could This Evolve Into the Primary Approach for Global Implementation of FATCA?*, 30 J. TAX'N INV. 3, 3 (2013) (analyzing the FATCA agreements and determining the effectiveness of them). Schmidt & Nydegger note:

> The Russian Ministry of Finance, for example, issued a letter on April 24, 2012, stating the Russian position is that FATCA breaches the principle of sovereign equality of states, and that Russian law does not envisage compulsory enforcement of claims of U.S. tax authorities. Further, the letter noted that compliance with FATCA would lead to a breach of Russian banking secrecy laws and result in Russian financial institutions being liable for damages. . . . [C]hanges to Russian law for the sake of compliance with FATCA have been ruled out, and that [the Russian Ministry of Finance] will seek [to negotiate] an IGA.

Id. at 6.

that is necessary to determine whether holders are specified U.S. persons.[109] Once the foreign financial institution identifies the accounts, it then adheres to verification and due diligence procedures prescribed by the IRS.[110] Upon IRS request, the foreign financial institution also provides information, such as the name, address, Tax Identification Number, the account numbers, balance of accounts, and gross receipts and withdrawals for each account for a specified time period.[111] Annually, the

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[109] *See* 26 U.S.C. § 1471(b)(1)(A) (stating that the institution agrees to find out if an account holder is a United States specified account holder). *See also* MCGILL, *supra* note 93, at 115–16 (noting that being a U.S. citizen is not the status that make one a specified U.S. person). McGill claims that those who have American parents, who have ever held a green card, or been physically present in the United States over a certain limit are responsible for reporting and paying taxes to the IRS. *Id*. at 116.

[110] *See* 26 U.S.C. § 1471(b)(1)(B) (establishing that financial institutions agree "to comply with such verification and due diligence procedures as the Secretary may require with respect to the identification of United States accounts."); DEP'T OF TREASURY, MODEL 1A IGA ANNEX I, DUE DILIGENCE OBLIGATIONS FOR IDENTIFYING AND REPORTING ON U.S. REPORTABLE ACCOUNTS AND ON PAYMENTS TO CERTAIN NONPARTICIPATING FINANCIAL INSTITUTIONS 1–3 (Nov. 30, 2014), http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Annex-I-to-Model-1-Agreement-11-30-14.pdf [http://perma.cc/SLV3-ZWEL] (presenting how the foreign government must gather information to verify that the holder is a specified U.S. holder and how the IRS would like them to report the information).

[111] 26 U.S.C. § 1471(b)(1)(E); *id.* § 1471(c)(1)(A)–(D). *See* DEP'T OF TREASURY, RECIPROCAL MODEL 1A AGREEMENT, PREEXISTING TIEA OR DTC: AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF [FATCA PARTNER] TO IMPROVE INTERNATIONAL TAX COMPLIANCE AND TO IMPLEMENT FATCA 9–12 (Nov. 6, 2014), http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-11-30-14.pdf [http://perma.cc/499Q-DUKD] [hereinafter MODEL 1A AGREEMENT] (listing FATCA Partner reporting responsibilities). Article two of this Model Agreement, which is subtitled "Obligations to Obtain and Exchange Information with Respect to Reportable Accounts," states:

> 2. The information to be obtained and exchanged is:
>
> a) In the case of [FATCA Partner] with respect to each U.S. Reportable Account of each Reporting [FATCA Partner] Financial Institution:
>
> (1) the name, address, and U.S. TIN of each Specified U.S. Person that is an Account Holder of such account and, in the case of a Non-U.S. Entity that, after application of the due diligence procedures set forth in Annex I, is identified as having one or more Controlling Persons that is a Specified U.S. Person, the name, address, and U.S. TIN (if any) of such entity and each such Specified U.S. Person;
>
> (2) the account number (or functional equivalent in the absence of an account number);
>
> (3) the name and identifying number of the Reporting [FATCA Partner] Financial Institution;
>
> (4) the account balance or value (including, in the case of a Cash Value Insurance Contract or Annuity Contract, the Cash Value or surrender value) as of the end of the relevant

foreign financial institutions deliver the IRS detailed reports with respect to each U.S. account identified.[112] In addition, foreign financial institutions that signed a FATCA agreement must withhold thirty percent from "passthru payments" to foreign financial institution who have not signed a FATCA agreement.[113] Currently, 77,000 foreign financial institutions and over eighty governments agreed to comply with the FATCA reporting.[114]

2. Foreign Financial Institutions and Non-Financial Foreign Institutions

The FATCA relies on agreements between the IRS, governments, and foreign financial institutions to fulfill the reporting regime.[115] Title 31 of the United States Code outlines laws regarding money and finance, and identifies numerous entities as financial institutions.[116] "[A] business in

> calendar year or other appropriate reporting period or, if the account was closed during such year, immediately before closure . . . .

Id. at 9.

112 26 U.S.C. § 1471(b)(1)(C)–(D). *See* MODEL 1A AGREEMENT, *supra* note 111, at 1 (noting that the FATCA is a "reporting regime for financial institutions with respect to certain accounts").

113 26 U.S.C. § 1471(b)(1)(D)(i). *See* MODEL AGREEMENT 1A, *supra* note 111, at 16 ("The Parties are committed to work together, along with Partner Jurisdictions, to develop a practical and effective alternative approach to achieve the policy objectives of foreign passthru payment and gross proceeds withholding that minimizes burden."); *see also* Caroline Rule, *"Passthrough Payments" Under FATCA: U.S. Withholding Tax on Non-U.S. Source Income*, 13 J. TAX PRAC. & PROC. 33, 33 (2011) (listing "interests . . . dividends, rents, salaries, wages, premiums, annuities, compensations . . . [and other payments] from sources within the United States").

114 Matthew D. Lee & Jeffrey M. Rosenfeld, *Offshore Tax Enforcement Update: Foreign Bank Account Disclosure Deadline Is June 30, 2014*, BLANK ROME LLP 2 (June 30, 2014), http://www.blankrome.com/siteFiles/Publications/0F76C00588025B63EF1F0EDE11DB44E4.pdf [http://perma.cc/MVZ4-MMVD]; *see* Robert Goulder, *The Vatican Bank, Christmas Cheer, and FATCA*, FORBES (Dec. 24, 2014), http://www.forbes.com/sites/taxanalysts/2014/12/24/the-vatican-bank-christmas-cheer-and-fatca/ [http://perma.cc/4LNX-NZTB] (revealing that the Vatican Bank signed a compliance agreement).

115 *See* Schmidt & Nydegger, *supra* note 108, at 3 (recognizing that the IRS regulates foreign financial institutions through entering into intergovernmental agreements to implement the FATCA). Congress developed the FATCA to make "foreign" institutions parties to the agreements, which in fact, does not include institutions incorporated or operating any branch located within the United States. *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (statement of Sen. Levin) (addressing that the reason this law should be enacted is so that people cannot get away with using foreign entities for tax evasion and money laundering).

116 *See generally* 31 U.S.C. § 5312(a)(2) (2012) (noting that insured banks, commercial banks, trust companies, private bankers, a branch of a foreign bank in the United States, credit unions, brokers, investment bankers, currency exchanges, credit card systems, insurance companies, pawnbrokers, dealers in precious metals, stones or jewels, the United States Postal Service, among others named, are financial institutions); United States v. Hom, 45 F. Supp. 3d 1175, 1179 (N.D. Cal. 2014) (holding that online casinos are financial institutions

the transmission of funds, including any person who engages as a business in an informal money transmission or any network of people who engage as a business and facilitate the transfer of money domestically or internationally outside the conventional financial institutions" is one of several definitions of a financial institution.[117] The FATCA, on the other hand, provides a wider definition of financial institutions that includes various kinds of entities.[118] The language of the FATCA states that a financial institution:

> (A) accepts deposits in the ordinary course of a banking or similar business,
> (B) as a substantial portion of its business, holds financial assets for the accounts of others, or
> (C) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities (as defined in section 475(c)(2) without regard to the last sentence thereof), partnership interests, commodities (as defined in section 475(c)(2)), or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.[119]

From this enabling statute, the IRS developed five basic financial institutions; however, this Note focuses only on three financial institutions: (1) depository institutions; (2) custodial institutions; and (3) investment entities.[120] A depository institution is "any entity

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under 31 U.S.C. § 5312 and U.S. persons have a responsibility to report their accounts to the IRS for FBAR).

117 31 U.S.C. § 5312(a)(2)(R). *See generally* United States v. E-Gold, Ltd., 550 F. Supp. 2d 82, 83 (D.C. Cir. 2008) (holding that E-Gold Limited is a money transmitter business). E-Gold Limited is a virtual wallet provider of E-Gold. *Id.* at 85. E-Gold was not licensed as a money transmitter under 31 U.S.C. § 5330. *Id.* at 84. The court wrote "that a 'money transmitting business' as defined in Section 5330 includes all financial institutions that fall outside the conventional financial institutions system." *Id.* at 94. Investopedia provided a definition compelling the Court in *MiCash v. Netspend Corp.*, No. 2:12-CV-248-JRG, 2013 WL 3803470, at *8 (E.D. Tex. July 17, 2013). "Conventionally, financial institutions are composed of organizations such as banks, trust companies, insurance companies and investment dealers." *Id.*

118 *See* Behrens, *supra* note 93, at 213 (acknowledging that the FATCA is broad and includes financial institutions and non-financial institutions).

119 26 U.S.C. § 1471(d)(5) (2012).

120 *See* Portfolio 6565, *supra* note 94, at Part III.A.2 (classifying the types of entities that the FATCA targets for reporting). The other types of financial institutions are "specified insurance companies, and certain holding companies or treasury centers." *Id.* Insurance companies and holding companies, that are "member[s] of an expanded affiliated group" ("EAG"), are financial institutions if the insurance companies or holding companies issue or

that . . . [a]ccepts deposits in the ordinary course of business or similar business."[121] A custodial institution holds financial assets for the benefit of one or more other persons as a substantial portion of their business.[122] An investment entity is described as an "entity [that] primarily conducts . . . [t]rading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign currency; foreign exchange, interest rate . . . [or] investing, administering, or managing funds, money, or financial assets on behalf of other persons."[123]

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is "obligated to make payments" by insurance or annuity contracts. 26 C.F.R. § 1.1471-5(e)(1)(iv) (2015). Holding companies and treasury centers can be considered financial institutions if they are "in connection with or availed of by a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets." *Id.* § 1.1471-5(e)(1)(v)(B). Although some entities would meet the definition of a financial institution, the IRS excludes entities specifically listed in the C.F.R., including excepted nonfinancial group entities, excepted nonfinancial startup companies, excepted nonfinancial entities in liquidation or bankruptcy, excepted inner-affiliate foreign financial institutions, section 501(c) entities, and nonprofit organizations. *Id.* § 1.1471-5(e)(5)(i)–(vi).

121 26 C.F.R. § 1.1471-5(e)(1)(i). The following activities are listed to determine the designation of a bank or similar business:

> (A) Mak[ing] personal, mortgage, industrial, or other loans or provides other extensions of credit;
> (B) Purchas[ing], sell[ing], discount[ing] or negotiat[ing] accounts receivable, installment obligations, notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness;
> (C) Issu[ing] letters of credit and negotiat[ing] drafts drawn thereunder;
> (D) Provid[ing] trust or fiduciary services;
> (E) Financ[ing] foreign exchange transactions; or
> (F) Enter[ing] into, purchas[ing], or dispos[ing] of finance leases or leased assets.

Id. § 1.1471-5(e)(2)(i)(A)–(F).

122 *Id.* § 1.1471-5(e)(3)(i)(A). "Substantial portion" means that the twenty percent or more of the gross income is attributed to holding the financial assets and related financial services during a measurement period. *Id.* A measurement period is "the shorter of (1) [t]he three year period ending on December 31 of the year preceding the year in which the determination is made; or (2) [t]he period during which the entity has been in existence before the determination." *Id.* § 1.1471-5(e)(3)(i)(A)(1)–(2).

123 26 C.F.R. § 1.1471-5(e)(4)(i)(A). Investment entities are entities that conduct certain investment management activities, on behalf of customers, and hold themselves out as a collective investment vehicle or similar investment vehicle. *Id.* § 1.1471-5(e)(4)(i)(A)–(C). *See* Christopher Condon, *Spiderwoman Brings Hope to Winklevoss Twins' Bitcoin ETF*, BLOOMBERG BUS. (Aug. 14, 2014), http://www.bloomberg.com/news/2014-08-15/spiderwoman-brings-hope-to-winklevoss-twins-bitcoin-etf.html [http://perma.cc/EBY2-QF2P] (reporting that a New York attorney, nicknamed "Spiderwoman," is working to build a Bitcoin trust company with the SEC).

3. Foreign Financial Accounts and Foreign Financial Assets

Once foreign financial institutions agree to participate in a FATCA agreement, the IRS requires the institutions to identify U.S. financial accounts.[124] To determine whether a foreign financial institution maintains a U.S. account, the IRS considers which person is the holder of the account, and if he is a "specified U.S. person" or U.S. owned foreign entity.[125] Financial accounts include depository accounts, custodial accounts, equity or debt interests, and certain insurance or annuity contracts.[126] If the aggregate balance of all depository accounts held by an individual does not exceed $50,000 at the end of the calendar year or on the date on which the account is closed, it may not be required to be reported.[127] However, a participating foreign financial institution may elect to forgo this de minimis rule and report all accounts regardless of balance or U.S. status.[128] In addition, intergovernmental agreements may list exclusions or inclusions unique to each agreement.[129]

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[124] *See* United States v. Hom, 45 F. Supp. 3d 1175, 1180 (N.D. Cal. 2014) ("[A]n account's location is determined by the location of its host institution, not where the physical money might be stored after it is sent to the financial institution."); Portfolio 6565, *supra* note 94, at Part III.B.1 (noting that financial institutions are required to gather enough information to determine whether the account holder is a U.S. person).

[125] *See* MODEL 1A AGREEMENT, *supra* 111, at 7 (presenting language that the IRS currently uses in its agreements). The agreement provides the definition of a U.S. person as:

> [A] U.S. citizen or resident individual, a partnership or corporation organized in the United States or under the laws of the United States or any State thereof, a trust if (i) a court within the United States would have authority under applicable law to render orders or judgments concerning substantially all issues regarding administration of the trust, and (ii) one or more U.S. persons have the authority to control all substantial decisions of the trust, or an estate of a decedent that is a citizen or resident of the United States. This subparagraph 1(ee) shall be interpreted in accordance with the U.S. Internal Revenue Code.

Id. *See* MCGILL, *supra* note 93, at 116 (claiming that those who have American parents, or who have ever held a green card or been physically present in the United State over a certain limit are responsible for reporting and paying taxes to the IRS).

[126] Portfolio 6565, *supra* note 94, at Part III.B.2. "Several types of accounts that would otherwise be financial accounts are specifically excepted from the definition of financial account, including certain retirement or savings accounts, certain term life insurance contracts, accounts held by an estate, certain escrow accounts, and certain annuity contracts." *Id*. *See* 26 C.F.R. § 1.1471-5(b)(2)(i)–(v) (2015) (listing the types of accounts that are exceptions to the definition).

[127] *See* 26 C.F.R. § 1.1471-5T(a)(4)(i) (2015) (limiting the number of accounts that will be reported to a least have $50,000 in the account).

[128] *See* 26 C.F.R. § 1.1471-5(a)(4)(ii) (inferring that foreign financial institutions could report the account information of any of their account holders regardless of the value of assets in the account).

[129] *See id.* § 1.1471-5(b)(2)(vi) (noting that agreements can cater to financial institutions).

Once the accounts are identified, the financial institution must report the assets within.[130] *Black's Law Dictionary* provides that an asset is "[a]n item that is owned and has value" and is the "property of a person . . . for distribution."[131] The FATCA does not clearly indicate what an asset is for foreign financial institutions, but provides the following definition:

> [T]he term "specified foreign financial asset" means—
> (1) any financial account (as defined in section 1471(d)(2)) maintained by a foreign financial institution (as defined in section 1471(d)(4)), and
> (2) any of the following assets which are not held in an account maintained by a financial institution (as defined in section 1471(d)(5))—
> (A) any stock or security issued by a person other than a United States person,
> (B) any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and
> (C) any interest in a foreign entity (as defined in section 1473).[132]

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[130] *See* MODEL 1A AGREEMENT, *supra* note 111, at 9 (listing the obligations of financial institutions that agree with the agreement). The agreement states:

> (4) the account balance or value (including, in the case of a Cash Value Insurance Contract or
> Annuity Contract, the Cash Value or surrender value) as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during such year, immediately before closure;
> (5) in the case of any Custodial Account:
> (A) the total gross amount of interest, the total gross amount of dividends, and the total gross amount of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and
> (B) the total gross proceeds from the sale or redemption of property paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the Reporting [FATCA Partner] Financial Institution acted as a custodian, broker, nominee, or otherwise as an agent for the Account Holder;
> (6) in the case of any Depository Account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period . . . .

Id. at 9–10.

[131] *Asset*, BLACK'S LAW DICTIONARY (9th ed. 2009).

[132] 26 U.S.C. § 6038D(b) (2012).

Although the FATCA provides these definitions, the scope is broad and comprises a multitude of different interpretations.[133]

4. Criticisms of the FATCA

Implementing an efficient tax system requires that provisions are "equitable, result in minimal deadweight loss, and be possible for the government to implement and enforce."[134] Yet, investigators estimate that implementing the FATCA will cost financial institutions a lot and lessen market efficiency.[135] This tax scheme is estimated to burden U.S. account holders who work abroad and thus are subject to both U.S. taxes and foreign taxes.[136] Reports show that Americans abroad have undeclared their citizenship to avoid the tax system.[137]

Furthermore, the United States traditionally has a voluntary tax system in which the government and its citizens expect Americans to report everything required.[138] Critics perceive the FATCA as not

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133 *See infra* Part III.B.3 (recommending that the IRS considers virtual currency as a financial asset for purposes of FATCA reporting).

134 Leandra Ledermen, *Stranger than Fiction: Taxing Virtual Worlds*, 82 N.Y.U. L. REV. 1620, 1658 (2007).

135 *See* John Koskinen et al., *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*, 2013 ANNUAL REPORT TO CONGRESS 238, 243 (2013), http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/REPORTING-REQUIREMENTS-The-Foreign-Account-Tax-Compliance-Act-Has-the-Potential-to-Be-Burdensome,-Overly-Broad,-and-Detrimental-to-Taxpayer-Rights.pdf [http://perma.cc/4EKW-V65Y] ("By way of comparison, industry sources believe that overall private sector implementation costs could equal or exceed the amount that FATCA is projected to raise. The IRS costs associated with long term development and implementation of the FATCA regime have not been systematically quantified."); Van Heukelom, *supra* note 92, at 165 (relaying that corporate compliance costs will be enormous and disrupt international finance efficiency).

136 *See* Helena Bachmann, *Mister Taxman: Why Some Americans Working Abroad Are Ditching Their Citizenships,* TIME (Jan. 31, 2013), http://world.time.com/2013/01/31/mister-taxman-why-some-americans-working-abroad-are-ditching-their-citizenships/ [http://perma.cc/ZBT8-6CZJ] ("The U.S. is the world's only industrialized nation that taxes citizens who live overseas, even if their income is generated in a foreign country and they never return to America."); Robert W. Wood, *Americans Renouncing Citizenship Up 221%, All Aboard The FATCA Express*, FORBES (Feb. 6, 2014), http://www.forbes.com/sites/robertwood/2014/02/06/americans-renouncing-citizenship-up-221-all-aboard-the-fatca-express/ [http://perma.cc/BLK5-BRZM] (expressing that the FATCA burdens those who live abroad to the point where they renounce citizenship so financial institutions do not have to report their assets).

137 *See* Wood, *supra* note 136 ("No group is more severely impacted than U.S. persons living abroad.").

138 *See* Flora v. United States, 362 U.S. 145, 176 (1960) ("Our system of taxation is based upon voluntary assessment and payment, not upon distraint."); *see also* Van Heukelom, *supra* note 92, at 161 ("By enacting Chapter 4 of Subtitle A of the Internal Revenue Code, Congress created the overarching framework for FATCA."). Berger clarifies that:

voluntary because it "force[s] the industry to find and report the income of American[s]" or the IRS will withhold payments.[139] Even under those circumstances, numerous nations have agreed to this system, with the intentions of implementing a similar system of their own.[140]

D. How Cryptocurrencies Are Treated Under the FATCA

Scholars, professionals, and the IRS have contemplated whether virtual currency should be reported under the FATCA.[141] Some argue that virtual wallets or exchanges would never enter into an agreement with the

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> Americans are required to report foreign financial assets under FBAR. The IRS mandates that as a U.S. citizen "you must report income from all sources within and outside of the U.S." Failure to report income that is earned abroad or maintained in accounts abroad is a crime. Currently, the U.S. has many different laws and treaties that are designed to regulate the taxation of foreign income and investigate individuals who evade paying these taxes. To date they have proven largely unsuccessful in reducing offshore tax evasion.

Berger, *supra* note 10, at 65. *See also* Jaffe & Co., AM. TAX INT'L, http://www.jaffeandco.com/fbar--fatca.html [perma.cc/Y428-GV93] (distinguishing the difference between FBAR and the FATCA). This source notes:

> The primary difference between FBAR and the FATCA is that the Form 114 is an information return that is reported to the Treasury Department's Financial Crimes Enforcement Network ("FinCEN"), while the FATCA Form(s) 8938 are additional scheduled items individually reported within the Form 1040. The FBAR is not filed with the Form 1040—it is sent separately to the Treasury's FinCEN. The FinCEN wants to make sure you are not hiding any foreign assets; while the IRS wants to make sure you are paying all the tax you owe on gains in your foreign assets.

Id.

139 MCGILL, *supra* note 93, at 115. *See* Sanat Vallikappen, *Why Foreign Banks Are Shunning American Millionaires*, BLOOMBERG BUS. (May 17, 2012), http://www.bloomberg.com/bw/articles/2012-05-17/why-foreign-banks-are-shunning-american-millionaires [http://perma.cc/UY6U-XR7E] (illustrating that entities are refusing to do business with Americans because of the penalties).

140 *See* Dep't of Treasury, *FATCA Archive Resource Center,* http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx [http://perma.cc/QXP7-XHWN] (publishing all the jurisdictions that signed a FATCA agreement). Some foreign financial institutions "would make FATCA information disclosures directly to their own governing bodies." Van Heukelom, *supra* note 92, at 165. "Countries that enter into these agreements . . . will be obligated to collect information from [foreign financial institutions] in their countries and make automatic information transfers to the United States." *Id. See* Alison Smale, *Nations Sign Pact to Share Data to Fight Tax Evasion*, N.Y. TIMES (Oct. 29, 2014), http://www.nytimes.com/2014/10/30/business/international/nations-sign-pact-to-share-data-to-fight-tax-evasion.html [http://perma.cc/7J6A-HU3X] (crediting the United States as the inspiration for the new German tax system that exchanges tax information with other countries).

141 *See infra* Part II.D (revealing the predictions of scholars, professionals, and the IRS's stance on whether virtual currency is a financial asset for the FATCA).

IRS because the virtual market is too different from the traditional financial system.[142] Another scholar argues Bitcoins are commodities and anticipates that some Bitcoin exchanges would be deemed foreign financial institutions by being a business that trades commodities.[143] Few agree that there are certain exchanges that might be subject to reporting, while others assume that certain government agreements already include virtual currency exchanges.[144] Professionals also discuss whether virtual wallets and exchange accounts can be reported, but most expect that IRS will require that some wallets and exchanges would be required to report.[145]

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[142] *See* Gruber, *supra* note 3, at 201 (declaring that a "Bitcoin hedge fund located in Malta prohibits United States persons or institutions from accessing or investing in the fund" to avoid the FATCA); *infra* Part III.B.2 (addressing issues with the virtual market, but also concluding that the IRS could include the virtual wallet in the FATCA agreements).

[143] *See* McLeod, *supra* note 50, at 400 ("The Bitcoin exchanges arguably should be deemed [foreign financial institutions] because they are engaged in the business of trading commodities, which qualifies under [26 U.S.C.] § 1471(d)(5)(C)."). *But see* Nicole Mirjanich, *Digital Money: Bitcoin's Financial and Tax Future Despite Regulatory Uncertainty*, 64 DEPAUL L. REV. 213, 214 (2014) (arguing that Bitcoin should not be classified as property or a commodity); Eric P. Pacy, *Tales from the Cryptocurrency: On Bitcoin, Square Pegs, and Round Holes*, 49 NEW ENG. L. REV. 121, 138 (2014) (concluding that Bitcoins are not a commodity).

[144] *See* WILLIAM H. BYRNES & ROBERT J. MUNRO, MONEY LAUNDERING, ASSET FORFEITURE AND RECOVERY AND COMPLIANCE—A GLOBAL GUIDE 4–5 (2015) (assuming that the signed intergovernmental agreement by Japan will require the virtual exchanges to comply with the FATCA information gathering and reporting requirements); Omri Marian, *Are Cryptocurrencies Super Tax Havens?*, 112 MICH. L. REV. FIRST IMPRESSIONS 38, 46 (2013) ("It might be possible for tax authorities to regulate such intermediaries in the same manner in which they regulate financial intermediaries under the FATCA regime. Such FATCA-like regulation, however, is only useful at the point of exchanges of Bitcoin to government-issued currencies.").

[145] *See* Alison Bennett, *Bitcoin Accounts May Be Subject to FBAR, FATCA Reporting as IRS Focus Sharpens*, DAILY TAX REPORT (Nov. 13, 2014), http://www.kflaw.com/siteFiles/News/F196CFF0D1A33B8D4B895F9ABE316B8C.pdf [http://perma.cc/2GN9-WCBC] ("[T]here is a real chance that the Treasury will conclude that bitcoin accounts held in foreign exchanges will be foreign financial accounts subject to FBAR reporting."); Tyson Cross, *Topic 7: Foreign Account Reporting*, BITCOINASS'N, http://bitcoinassociation.org/bitcoin-taxation-part-7-foreign-account-reporting-requirements/ [http://perma.cc/7RSZ-333C] (deciding that exchanges will likely be subject to reporting requirements but unsure of whether virtual wallets will be required to report); Keith Miller, Richard Peterson & Joseph Cutler, *Virtual Currency Exchange Accounts, Hosted Wallet Services, and Vault Services Abroad May Trigger FBAR Filing Requirements*, NYSSCPA (Feb. 1, 2015), http://www.nysscpa.org/taxstringer/2015/feb/miller.htm [http://perma.cc/9WAS-S3NJ] (concluding that virtual currency would be reportable for FBAR and the FATCA); Rajiv Prasad, *FBAR and FATCA Compliance in the Age of Digital Currencies*, TAX ADVISER (May 1, 2014), http://www.aicpa.org/Publications/TaxAdviser/2014/may/Pages/clinic-story-07.aspx [http://perma.cc/49RP-2XXR] (determining that exchanges and any site that holds the assets should be characterized as a financial institution for FATCA); David Shapiro, *Bitcoin Held Through Foreign Exchanges: Filing Issues*, SHAPIRO TAX LAW (Mar. 31, 2014), http://www.shapirotaxlaw.com/bitcoin-held-through-foreign-exchanges/

The IRS purposefully did not address the FATCA in the Virtual Currency Tax Guidance published early in 2014.[146] Instead, it chose to investigate and study the role of virtual market to determine proper treatment in the current tax system.[147] Now that the IRS is enforcing the FATCA, some believe evaders will use virtual channels in search of a new tax haven.[148]

III. ANALYSIS

The ambiguity and uncertainty of the FATCA and its agreements creates issues. Tax evaders may be under the impression that the IRS's silence indicates a lackadaisical approach.[149] Therefore, evaders lean toward the virtual market as a viable option for tax evasion.[150] Also, governments and financial institutions, which have already entered into FATCA agreements, will be uncertain of their responsibilities to report virtual currency as the popularity and regulations of the virtual market

[http://perma.cc/H7UM-KSBT] (expressing that exchanges could be subject to the FATCA and FBAR).

146 *See generally* IRS Notice, *supra* note 89, at 938–40 (omitting any indication that virtual currency is to be reported for FBAR and the FATCA purposes); Bennett, *supra* note 9 (noting that the IRS has not published an opinion on whether virtual currency is reported under the FATCA).

147 *See* Jan Johansen, *IRS Not Revealing Hand While Keeping Straight Face on Bitcoin*, NEWSWIRE (Oct. 9, 2014), http://newswire.net/newsroom/pr/00085481-irs-quietly-watching-bitcoin-and-other-crypto-currency.html [http://perma.cc/DQ4Q-QL4E] (reporting that the IRS is investigating whether FATCA can include the virtual market to reporting requirements). *See also* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-516, VIRTUAL ECONOMIES AND CURRENCIES: ADDITIONAL IRS GUIDANCE COULD REDUCE TAX COMPLIANCE RISKS 19 (2013) (noting that the government is working towards a way to regulated virtual currencies). The IRS:

> [I]s aware of the potential tax compliance risks posed by off-shore and anonymous electronic payment systems, and we are working to address these risks. Our efforts have included discussions with other federal agencies, evaluating our agents' expertise, developing continuing professional education curricula, providing online and classroom training, and creating lead sheets and questionnaires for agent use during examinations.

Id.

148 *See supra* Part II (referring to the concerns of virtual currency as the new tax haven); *see also* Gruber, *supra* note 3, at 139 (addressing that virtual currency could be abused for money laundering and tax evasion); Hardy & Zaman, *supra* note 53 (recognizing the potential for abuse of virtual currency now that the FATCA passed).

149 *See* Bennett, *supra* note 9 (acknowledging that the IRS is aware of virtual currency, but declined to comment on whether it is reported for the FATCA).

150 *See* French, *supra* note 9 (speculating that Bitcoin's popularity increase may not be a result of the FATCA implementation); Singer, *supra* note 13 (assuming that now that the FATCA targets traditional ways to prevent tax evasion, evaders are likely going to use virtual channels).

change in different jurisdictions.[151] Some countries may pointlessly overextend their resources to report virtual currency while others do not.[152]

The IRS should dispel the ambiguity by including the virtual market in their agreements by asking governments and virtual wallet providers to report Americans' cryptocurrencies to reduce tax evasion.[153] Part III.A analyzes a current Model Agreement the Department of Treasury presents to a potential FATCA partner.[154] Part III.B analyzes the FATCA's authority over virtual wallet providers, virtual wallets, and virtual currency.[155] Part III.C provides examples of the language that the IRS should incorporate in the FATCA agreements to extend power over virtual wallet providers.[156] Requiring virtual wallet providers to report virtual currency under the FATCA will help reduce and prevent tax evasion.[157]

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[151] *See supra* note 66 and accompanying text (noting that American laws and other countries regulate the virtual market differently, which complicates whether the FATCA can require countries to force virtual wallet providers to report the assets of individuals).

[152] *See generally* THE LAW LIBRARY OF CONG., *supra* note 66, at 1 (presenting the virtual currency laws in different countries); Farber et al., *supra* note 66 (identifying countries who are more strict on virtual currency and others who are more relaxed about it).

[153] *See supra* Part II.D (exposing the various speculations of scholars and professionals regarding whether the FATCA will regulate the virtual market); *infra* Part IV (amending the FATCA agreements by including the virtual market terminology).

[154] *See infra* Part III.A (evaluating the effectiveness of a Model Agreement and determining that adding virtual wallet terminology is the best way to reduce tax evasion through virtual means).

[155] *See infra* Part III.B (commenting that the FATCA agreements and reports should include virtual wallet providers, virtual wallets and virtual currency).

[156] *See infra* Part IV (proposing language that the IRS should add to agreements or modify pending agreements).

[157] *See* Prasad, *supra* note 145 (agreeing that virtual exchanges could be subject to the FATCA obligations). Other articles addressed regulating virtual currency, but found that current U.S. laws are insufficient because they require supplemental schemes to strengthen them. *See generally* Grinberg, *supra* note 66, at 206 (admitting that it is not clear whether virtual currencies would be subject to the regulations); Kaplanov, *supra* note 28, at 114 (noting that virtual currency falls outside the current regulatory schemes); Matthew Kien-Meng Ly, *Coining Bitcoin's "Legal-Bits": Examining the Regulatory Framework for Bitcoin and Virtual Currencies*, 27 HARV. J.L. & TECH. 587, 608 (2014) (assuming that the government knows that regulations need development regarding virtual currency). These conclusions do not conflict with this Note because although the FATCA alone could regulate some foreign financial institutions, amending the statute and boilerplate agreements would make the reporting more effective. *See infra* Part IV.B (recognizing that there are weaknesses and restrictions that make the FATCA insufficient to prevent tax evasion on a large scale).

A. *The IRS Model Agreement Is a Good Starting Point for the Virtual Market to be Reported Under a FATCA Agreement*

The IRS should correct the intergovernmental agreements and foreign financial institution agreements to include virtual wallet terminology because the virtual market is similar to the current financial system.[158] The Department of Treasury provides models of intergovernmental agreements, but does not explicitly include language indicating intent to report virtual wallet providers.[159] Although one can interpret the FATCA to include the virtual economy without new provisions, redefining, or adjusting the agreements to clearly include virtual terminology is necessary to remove the problems associated with the ambiguity.[160] Without adding the language, evaders may use virtual channels to conceal their money now that the FATCA targeted traditional ways to evade taxes.[161] The language will also serve to set a standard so that countries and foreign wallet providers know that the IRS's attention is on the virtual market.[162]

As noted, if governments or institutions do not enter into agreements, they are subject to financial penalties.[163] These contracts appear borderline unconscionable because the United States uses its bargaining power to influence parties to enter agreements.[164] Even so, governments

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158 *See infra* Part III.B.1–3 (interpreting virtual wallet providers as foreign financial institutions, virtual wallets as financial accounts and virtual currencies as financial assets). *But see* Singer, *supra* note 13 (quoting Omri Marian who states that, "Right now, [virtual currency is] not a major issue because the volume is very small compared to [the] world economy, but if it grows the way it's expected to grow, it could become an issue for the IRS and Congress . . . I'm not sure the IRS is well suited to work with bitcoin-based tax evasion through the tax code.").

159 *See* DEP'T OF TREASURY, *supra* note 105 (providing samples of the FATCA agreements that do not have any language that includes the virtual market).

160 *See supra* Part II.C.1 (establishing that the FATCA sets up agreements with financial institutions to avoid penalties the United States imposes on those who do not comply); *see also supra* note 158 and accompanying text (determining that virtual wallet providers, virtual wallets, and virtual currency can be foreign financial institutions, foreign financial accounts, and foreign financial assets respectively).

161 *See supra* Part II.C.1 (noting that President Obama and Congress were aware of Americans using banks to evade taxes and in the case of *United States v. U.S.B.*, the financial institution helped Americans evade taxes).

162 *See infra* Part IV (proposing language that includes the virtual market within the FATCA agreement).

163 *See* 26 U.S.C. § 1471(a) (2012) (stating that foreign financial institutions that do not report are penalized with a thirty percent withholding of U.S. source payments); *supra* Part II.C.1 (noting the penalties for foreign financial institutions that do not enter into a FATCA agreement).

164 *See* Browning, *supra* note 104 (portraying the United States as a selfish bully because they force countries and financial institutions to enter into agreements or suffer punishments under the FATCA).

are complying to continue good foreign relations with the United States.[165] Intergovernmental agreements are the most ideal because more virtual wallet providers must report and foreign governments may enforce virtual wallet provider compliance.[166] If the IRS cannot get an intergovernmental agreement, it ought to arrange a private agreement with foreign financial institutions.[167] These virtual wallet providers will be instructed to ask the foreign government to waive the foreign privacy laws so the foreign financial institution can comply or be forced to close any U.S. accounts.[168]

B. Virtual Market Terms Categorized With Their Traditional Financial Counterparts

The IRS is currently investigating and studying whether the FATCA should regulate the components of the virtual economy.[169] Independently, this Note finds that the IRS can and should ask countries and virtual wallet providers to report virtual currency.[170] The roles of virtual wallet providers, virtual wallets, and virtual currency are similar to the traditional financial institutions, accounts and assets directed under the FATCA.[171] Part III.B.1 examines whether virtual wallet providers meet

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165 *See* DEP'T OF TREASURY, *supra* note 105 (providing agreements that benefit foreign countries by promising reciprocal reporting of non-American assets); Nauheim & Cousin, *supra* note 107, at 183 (declaring that the United States negotiates bilateral agreements so that the FATCA partner is more likely to comply).

166 *See* Christiansen et al., *supra* note 106 (describing that intergovernmental agreements require that foreign financial institutions report to the local government, which later reports to the IRS); Schmidt & Nydegger, *supra* note 108, at 5 (stating that intergovernmental agreements make the parent country responsible for all financial institutions in its jurisdiction).

167 *See* Hirschfeld, *supra* note 107, at 61 (noting the process of how private financial institutions become FATCA partners); Nauheim & Cousin, *supra* note 107, at 195–96 (recognizing that countries who do not enter into an agreement cause the IRS to contact financial institutions to enter into private agreements).

168 *See* 26 U.S.C. § 1472 (b)(1)(F)(ii) (2012) (requiring institutions to close financial accounts if the foreign government does not sign an intergovernmental agreement or waive the laws so that the financial institution may comply).

169 *See* Johansen, *supra* note 147 (reiterating that the IRS purposely did not publish an opinion regarding whether the virtual market counterparts will be reported under the FATCA).

170 *See infra* Part IV (concluding that the IRS should make the proposed amendments and require countries and virtual wallet providers to report virtual assets to the United States).

171 *See infra* Part III.B.1–3 (reviewing laws classifying financial institutions, financial accounts and financial assets, including the FATCA, and determining that the IRS should consider virtual wallet providers, virtual wallets, and virtual currency as parts of the conventional financial system).

the definition of a foreign financial institution.[172] Part III.B.2 analyzes whether the IRS can consider virtual wallets as foreign financial accounts.[173] Next, Part III.B.3 scrutinizes whether the IRS can consider virtual currencies as foreign financial assets.[174]

1. Virtual Wallet Providers are Types of Financial Institutions

The IRS should identify virtual wallet providers as financial institutions based on the laws of the United States Code and the Code of Federal Regulations.[175] Virtual wallet providers, that are also platforms for exchanges, are financial institutions because virtual exchanges are financial institutions under the FinCEN regulation.[176] However, not all virtual wallet providers are exchange sites, so non-exchange virtual wallet providers are without classification.[177] Even so, the law the courts and FinCEN relied upon offers insight to what types of institutions are classified as financial institutions.[178] The United States Code states in pertinent part, "a licensed sender of money," and "business in the transmission of funds" is a financial institution.[179] Like the FinCEN

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172 *See supra* Part III.B.1 (advocating that the IRS should consider virtual wallet providers as foreign financial institutions).

173 *See supra* Part III.B.2 (establishing that virtual wallets can be foreign financial accounts for the FATCA reporting).

174 *See supra* Part III.B.3 (arguing that virtual currencies can be foreign financial assets that could be reported to the IRS).

175 *See* 26 U.S.C. § 1471(d)(5) (2012) (classifying a financial institutions as depository institutions, custodial institutions, or investment entities); 31 U.S.C. § 5312(a)(2)(R) (2012) ("[A]ny other person who engages as a business in the transmission of funds, including any person who engages as a business in an informal money transfer system of any network of people who engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system . . . ."); 31 C.F.R. § 1010.100(t)(3) (2014) (stating that any entity in subsection (ff) is a financial institution); 31 C.F.R. § 1010.100(ff)(1) (2014) (defining a money transmitter as accepting 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 through an electronic funds transfer network or informal value transfer system).

176 *See supra* Part II.B.2 (presenting the FinCEN regulations that states that virtual exchanges are financial institutions and therefore must be licensed as a money transmitter business).

177 *See* Part IV (proposing that non-exchange virtual wallet providers are financial institutions that should report the virtual assets of American persons).

178 *See supra* Part II.B (providing the current laws governing over virtual wallets and virtual wallet exchanges).

179 31 U.S.C. § 5312(a)(2)(R); *see* United States v. Faiella, 39 F. Supp. 3d 544, 546 (S.D.N.Y. 2014) (holding that the Bitcoin exchange should have been licensed as a money transmitter business and therefore a financial institution).

regulation, it targets exchange sites rather than sites that secure currency.[180]

Title 31's definitions and examples of financial institutions should be considered in determining whether a virtual wallet provider is a financial institution.[181] It states that a financial institution is a "network of people who engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system."[182] Recognizably, virtual currency markets exist because groups of people operate and transfer money "unconventionally" with few limitations of where it can be transferred.[183] However, this law appears to be tailored more to representing the entire virtual market rather than the component of holding the virtual currency.[184] Still, by evaluating the word "facilitate," one could argue that virtual wallet providers exists to enable transfers of virtual currency and therefore still should be considered a financial institution.[185] The drafters did not likely anticipate a virtual financial system, however it seems reasonable to include a virtual wallet entity as a financial institution under this criterion because it is a business that facilitate transfers with value.[186]

By extension, the IRS should interpret the FATCA regulations to include virtual wallet providers as a financial institution.[187] Looking at the language of the FATCA, some functions of financial institutions are

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180 *See supra* Part II.B.2 (establishing that businesses should be licensed with states that require it and later with the United States); *see also* Gruber, *supra* note 3, at 170 (discussing the authority that the Bank Secrecy Act gives to FinCEN over virtual currency exchanges).

181 *See generally* 31 U.S.C. § 5312(a)(2) (providing a list of different types of financial institutions such as banks, brokers, credit unions, precious metal, and gem dealers, etc.).

182 31 U.S.C. § 5312(a)(2)(R).

183 *See* VIGNA & CASEY, *supra* note 35, at 9 (characterizing the network as a comprised group of computers supporting the whole virtual financial system); Sec. & Exch. Comm'n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex. Aug. 6, 2013) ("The only limitation of Bitcoin is that it is limited to those places that accept it as currency."). *See generally Bitcoin ATM Map*, *supra* note 47 (presenting a map of all the locations of Bitcoin ATMs across the world).

184 *See* VIGNA & CASEY, *supra* note 35, at 8–9 (noting the difference be between "Bitcoin the money" and "bitcoin the technology"). The virtual system provides programming instructions, which allows computers to communicate with each other. *Id*. at 9. Essentially, these users maintain the whole system. *Id*. It would seem extreme to determine that individuals who run the system on their computers to be financial institutions. *See* FIN. CRIME ENFORCEMENT NETWORK, *supra* note 2, at 1 (explaining that there are exceptions to whether a person is a money transmitter).

185 31 U.S.C. § 5312(a)(2)(R).

186 United States v. Hom, 45 F. Supp. 3d 1175, 1179 (N.D. Cal. 2014) (holding that online casinos are financial institutions and therefore U.S. persons have a responsibility to report their accounts to the IRS for FBAR).

187 *See infra* Part IV (adding the term virtual wallet entity to the language of the FATCA agreement).

comparable to those of virtual wallet providers.[188] Virtual wallet providers are not banks.[189] However, providers arguably fall under Section 1471(d)(5)(a) as foreign financial institutions because providers are similar to entities that accept deposits in the ordinary course of business.[190] Likewise, account holders are capable of withdrawing and depositing values into virtual wallets.[191]

Interpretation of Title 31 of the United States Code Section 5314, provided by the *United States v. Hom*, supports the opinion that virtual wallet entities are financial institutions because the virtual wallet providers offer services traditionally provided by banks.[192] If other courts apply the same reasoning, they could find that wallet providers function as financial institutions because its holders can open wallets, control access to the wallets, deposit currency into the wallets, withdraw or transfer currency from the wallets at will, and carry a balance on the wallets.[193]

Virtual wallet providers promote themselves primarily as a secure storage service that sometimes charge a flat fee or a percentage fee of the value of the virtual currency.[194] Because of this principal service, an interpreter should identify a virtual wallet provider as a financial institution under the Code of Federal Regulation Section 1.1471-5(e)(1)(a).[195] Arguably, a virtual wallet provider acts like an "investment entity" listed in Section 1.1471-5(e)(1)(iii) if the virtual currency is considered a money market instrument.[196] As of right now, the only

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188 *See* 26 U.S.C. § 1471(d)(5) (2012) (defining financial institutions to be either a depository entity, custodial entity, investment entity, insurance entity, or holding company).

189 *See supra* note 121 and accompanying text (recognizing different activities of banks and similar business). Virtual wallet providers are not like banks because they do not offer loans. *Id.*

190 *See* 26 U.S.C. § 1471(d)(5)(A) (stating that "any entity that . . . accepts deposits in the ordinary course of banking or similar business" is a financial institution); Zhou, *supra* note 13 (referring to the bitcoin exchange and network as "a new way of doing what the banks have been doing").

191 *See supra* Part II.C (discussing the actions of virtual wallet providers).

192 *See* 45 F. Supp. 3d 1175, 1179 (N.D. Cal. 2014) (holding that online casinos functioned as banks because the defendant "opened up all three accounts in his name, controlled access to the accounts, deposited money into the accounts, withdrew or transferred money from the accounts to other entities at will, and could carry a balance on the accounts").

193 *See id.* (applying the *Hom* standard to the virtual wallet facts).

194 *See supra* note 65 and accompanying text (identifying the different ways virtual wallet providers are paid to secure virtual currency).

195 *See* 26 C.F.R. § 1.1471-5(e)(1)(ii) (2015) (stating an entity that "[h]olds, as a substantial portion of its business . . . financial assets" is a financial institution); *supra* Part II.C (presenting the functions of a virtual wallet provider).

196 *See* 26 C.F.R. § 1.1471-5(e)(1)(c) (referring readers to Section 1.1471-5(e)(4)(iii), which elaborates that an entity is a financial institution if it trades in money market instruments). *See also* Sec. & Exch. Comm'n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex.

instance that virtual currency was considered a money market instrument was in *SEC v. Shavers*.[197] However, Shavers was providing an investment opportunity, rather than an online wallet service.[198] Therefore, virtual wallet providers should be considered financial institutions under Section 1.1471-5(e)(1)(a) and (b) until courts or the SEC determine when financial institutions, that govern virtual currency, are acting as investment entities.[199]

2. Virtual Wallets are Equivalent to Financial Accounts

Based on the plain meaning and interpretation of the FATCA regulations, virtual wallets can be equivalent to foreign financial accounts.[200] The definitions that the IRS drafted for the Code of Federal Regulations would still categorize virtual wallets as financial accounts.[201] The definitions listed in Section 1.1471-5(b)(1)(i) and (ii) support the argument that virtual wallets are financial accounts.[202] With respect to the language in subsection (i), virtual wallets can act as depository accounts because account holders can control deposits, withdrawals and transfer

2013) (holding that Bitcoins for Shavers' purpose were like securities, and therefore the court had jurisdiction to hear the case). This sort of investment entity that Shavers created would likely be considered a financial institution under subsection (c). *Id.* at *1. However, Shavers' entity was not a virtual wallet provider. *Id.*

197 *See Shavers*, 2014 WL 4652121, at *2 (E.D. Tex. 2013) (holding that Bitcoin was used as a money instrument, and therefore the SEC had jurisdiction to prosecute the case). The court analyzed how the Bitcoins were being used to determine that it was a security. *Id.*

198 *See id.* at *1 (noting that Shavers conducted an investment entity "Bitcoin Savings and Trust").

199 *See generally id.* at *1–2 (analyzing whether the bitcoins were securities based on the circumstances and facts that were presented).

200 *See* 26 C.F.R. § 1.1471-5(b)(i)–(iii) (stating that depository accounts, custodial accounts, and types of investment accounts are financial accounts). The enabling statute is nearly the same language as the regulations, so it is not reviewed in depth. 26 U.S.C. § 1471(d)(2) (2012). In Title 31, Congress granted the Department of Treasury power to further define "financial account" of a financial institution. 31 U.S.C. § 5318A(e)(2). The Department then elaborated in the Code of Federal Regulations. 31 C.F.R. § 1010.350(c)(1)–(3). If authorities consider virtual wallets as financial accounts under this regulation, the reasoning should be carried over to Title 26 of the Code. *See* Hardy & Zaman, *supra* note 53 (discussing FBAR reporting). An American account holder must report foreign "bank" accounts, "securities" accounts, and "other financial" accounts holding assets. 31 C.F.R. §§ 1010.350(a), 1010.350(c)(1)–(3). One definition of an "other" account is "[a]n account with a person that is in the business of accepting deposits as a financial agency." *Id.* § 1010.350(c)(3)(i).

201 *See* 26 C.F.R. § 1.1471-5(b)(1)(i)–(iii) (defining different types of accounts: depository account, custodial account, and equity or debt interest related accounts).

202 *See id.* § 1.1471-5(b)(1)(i)–(ii) (listing depository accounts and custodial accounts as financial accounts).

currency to and from the wallets.[203] They serve as a place to store the virtual currency of the holders and as a place to transfer virtual currency, as if they were safety deposit boxes.[204] Certain wallets should be considered custodial accounts because the virtual wallet provider retains the holders' personal addresses so holders cannot transfer units without requesting it from the provider.[205] As long as the virtual wallet provider supplying the account is not incorporated in the United States (or any branch thereof is located in the United States), the virtual wallet is considered "foreign."[206] Consequently, foreign financial institutions in compliance with the FATCA will agree to report virtual wallets.[207]

3. Cryptocurrencies are Financial Assets

The IRS should clearly state that virtual currency is a foreign financial asset for the FATCA.[208] An asset is "property of a person . . . for distribution."[209] By declaring virtual currency as property, the IRS adopted the notion that cryptocurrency is an asset.[210] Politicians and individuals asked the IRS to reconsider this status because the protestors deem virtual currency to resemble foreign currency rather than

203 *See id.* § 1.1471-5(b)(1)(i) (stating that depository accounts are accounts in which the holder gets credit for currency from an institution that is in a banking or similar business); *supra* Part II.B (identifying the characteristics of a virtual wallet).

204 *See id.* § 1.1471-5(b)(3)(ii) (naming custodial accounts as financial accounts); *supra* Part II (explaining the functions of virtual wallets); *see also How Do Bitcoin Transactions Work?*, *supra* note 41 (relating virtual wallets to safety deposit boxes).

205 *See* Cross, *supra* note 145 (conceding that those virtual wallets that require the user to request a transfer would be considered a custodial account and would likely be subject to reporting requirements).

206 *See* 26 U.S.C. § 1471(d)(4) (2012) (defining a foreign financial institution as any financial institution that is not "organized under the laws of any possession of the United States"); Hardy & Zaman, *supra* note 53 ("[B]ranch[es] of a foreign bank physically located in the [United States] does *not* qualify."). According to the holding in *Hom*, the "account's location is determined by the location of its host institution, not where the physical money might be stored after it is sent to [the] financial institution." United States v. Hom, 45 F. Supp. 3d 1175, 1180 (N.D. Cal. 2014). Foreign financial accounts are digital constructs of a financial institution located in and regulated by foreign countries. *Id.* at 1179.

207 *See* Reutzel, *supra* note 66 (revealing that French regulations now apply to a bitcoin exchange after bought by a financial institution parent-company and therefore would likely report the virtual assets on a FATCA report).

208 *See* Hardy & Zaman, *supra* note 53, at 2 (stating that the IRS recognizes the risk of not reporting virtual currency); Bennett, *supra* note 9 (noting that the IRS has not published an opinion on whether virtual currency is reported under the FATCA).

209 *See Asset*, *supra* note 131 (defining the term "asset").

210 *See* IRS Notice, *supra* note 89 (declaring virtual currency as property that will be taxed on the capital gains or losses). *But see* Lewis, *supra* note 90 (rejecting the IRS's guidance as an illogical one because tax occurs when the virtual currency is mined as if it were income and not when it is sold).

property.[211] Others, however, agree that the IRS made the correct assessment in concurrence with current U.S. laws.[212] This classification as property allows the IRS to tax profits, but it is unfair due to the fluctuation in price.[213] If the IRS decides to change the property classification of virtual currency, it would still be an asset because cryptocurrency is an "item of value."[214] The *Faiella* court and the *Shavers* court support that virtual currency is an asset and reasoned that virtual currency is similar to money or funds for public policy reasons.[215] If the *Faiella* court is inclined to recognize that virtual currency threatens the annual tax revenue, then the IRS should include it within the FATCA agreements.[216]

Also, the broad language of the FATCA allows the IRS to demand financial institutions to report cryptocurrency.[217] Section 6038D(b)(1) of Title 26 indicates that if a foreign financial institution holds foreign accounts, whatever is held in the accounts are assets and should be reported.[218] Therefore, virtual currency in wallets is analogous to money in an account and thus should be reported the same way under the FATCA.[219]

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211 *See* Mirjanich, *supra* note 143, at 214 ("Bitcoin should be classified as 'currency' under all regulatory laws in the same fashion as other foreign currencies. Bitcoin should not be regulated as property or as a commodity."); Pacy, *supra* note 143, at 123 (arguing that virtual currency should be treated the same as "real" currency); *Stockman Plans to Introduce the "Virtual Tax Reform Act*," *supra* note 89 (disagreeing with the IRS, Representative Stockman seeks to make virtual currency real currency).

212 *See* Mack, *supra* note 34, at 762 (noting that the taxing virtual goods as property is the proper way to implement a virtual tax system). "The most obvious method of taxing virtual land and property transactions is through a capital gains tax, which is the scheme the IRS uses to tax real-world property sales." *Id.* "[U]sing current capital gains formulas would effectively allow the IRS to tax virtual profits . . . ." *Id.* *See also* Caron, *supra* note 89 (supporting the IRS by saying "the IRS guidance is an effective one . . . [i]t is clear, concise, and correct on the law").

213 *See supra* note 40 and accompanying text (noting that the price fluctuation of Bitcoin changes very quickly).

214 *See Asset*, *supra* note 131 (characterizing an asset as an "item of value"); *supra* note 89 and accompanying text (presenting different arguments for how virtual currency should be classified).

215 United States v. Faiella, 39 F. Supp. 3d 544, 546 (S.D.N.Y. 2014) (considering that Bitcoin can be money for the purposes of the statute); Sec. & Exch. Comm'n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex. 2013) ("It is clear that Bitcoin can be used as money.").

216 *Faiella*, 39 F. Supp. 3d at 546 (holding that Bitcoin was like money with the assumption that Congress defined the statute in anticipation that virtual currency would be a way for criminals to launder money).

217 *See* Part II.D (combining the opinions of professionals and scholars to conclude that the IRS should include the virtual market in the FATCA agreements).

218 *See* 26 U.S.C. § 6038D(b)(1) (2012) (defining a "specified foreign financial asset" to mean "any financial account maintained by a foreign financial institution").

219 *See* Part II.B (presenting court opinions and regulations interpreting virtual currency to be like money and make them an asset).

Furthermore, the broad language of the FATCA allows the IRS to ask foreign institutions to report "financial instruments."[220] Even if the IRS determines, after completing its investigation, that a virtual wallet is not a financial account, a foreign financial institution may still be required to report virtual assets if it was found as a financial instrument because of the ruling in *Shavers*.[221] Therefore, cryptocurrency should be reported even though there is not a specifically tailored provision in the language of the FATCA including virtual currency.[222]

IV. CONTRIBUTION

The FACTA agreements should specifically name virtual wallet providers as financial institutions so that virtual wallet providers are required to report virtual currency of U.S. account holders.[223] Without including this language in an agreement, it is likely that governments or foreign financial institutions will not report this information and purposely or accidently help Americans evade U.S. taxes. Part IV.A proposes language that should be added to both intergovernmental and private agreements.[224] Then, Part IV.B discusses the significance of the language.[225]

A. *Proposal*

Defining various virtual economy terms in the FATCA agreements is the best way to combat offshore tax evasion because it requires institutions or governments to thoroughly report assets of Americans, which in turn, gives the IRS superior knowledge of their proper tax liability. These definitions can be added to the model agreements that the IRS drafted.[226] For virtual currencies to be included, parties will need to modify all of

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[220] *See* 26 U.S.C. § 6038D(b)(2)(B) (explaining that any financial instrument that is not held in an account maintained by a financial institution is a specified foreign financial asset).

[221] *See Shavers*, 2013 WL 4028182, at *2 (holding that Bitcoins were money instruments and therefore within the jurisdiction of the SEC to prosecute).

[222] *See supra* Part III.B.3 (determining that virtual currency is an asset, even though it is not precisely defined as a commodity, stock, or security by statute or regulation, but by the fact it is valuable).

[223] *See infra* Part IV.A (proposing language to add to a model FATCA agreement so virtual wallet providers report virtual currency of American holders).

[224] *See infra* Part IV.A (interjecting language within a model FATCA agreement to reflect reporting of virtual currency).

[225] *See infra* Part IV.B (commenting on the words the author chose to add to the agreement).

[226] *See* MODEL 1A AGREEMENT, *supra* note 111 (providing a sample form of a standard model agreement).

these agreements to incorporate the language below.[227] This proposal will clarify the authority the FATCA has over the virtual market.[228] According to the model agreements supplied by the Department of Treasury's website, the following additions and amendments to the agreements should be phrased and organized as followed.[229]

Article 1
Definitions

1. For purposes of this agreement and any annexes thereto ("Agreement"), the following terms shall have the meanings set forth below:

a) The term **"United States"** means the United States of America, including the States thereof, but do not include the U.S. Territories. Any reference to a **"State"** of the United States includes the District of Columbia.

b) The term **"U.S. Territory"** means American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, the Commonwealth of Puerto Rico, or the U.S. Virgin Islands.

c) The term **"IRS"** means the U.S. Internal Revenue Service.

d) The term **"[FATCA Partner]"** means [full name of FATCA Partner][, including ____][, but not including ____].

e) The term **"Partner Jurisdiction"** means a jurisdiction that has in effect an agreement with the United States to facilitate the implementation of FATCA. The IRS shall publish a list identifying all Partner Jurisdictions.

f) The term **"Competent Authority"** means:

(1) in the case of the United States, the Secretary of the Treasury or his delegate; and

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227 *See supra* note 111 and accompanying text (indicating that there are governments and institutions that have agreements that do not include the virtual wallet terminology and therefore need to be modified).

228 *See* Schmidt & Nydegger, *supra* note 108, at 20 (concluding that intergovernmental agreements "will become the norm with respect to implementation of the FATCA on a global basis"). "The IGAs could go far toward addressing several problems in applying the FATCA in many countries by reducing compliance burdens and increasing clarity." *Id.* at 20–21. *See* Part II.C.1 (summarizing that the FATCA agreements are contracts between the IRS and the FATCA partner, which lay out the responsibilities of both parties).

229 *See* MODEL 1A AGREEMENT, *supra* note 111 (providing the language of a model FATCA agreement).

(2) in the case of [FATCA Partner], [].

*) *The term **"Virtual Currency"** means any type of digital unit that is used as a medium of exchange or a form of digitally stored value. Virtual Currency shall be broadly construed to include digital units that (i) are decentralized or (ii) may be created or obtained by computing or manufacturing efforts. Virtual currency shall not be construed to include digital values that are within closed markets such as game points, airline miles or loyalty rewards programs.*

*) *The term **"Fiat Currency"** means government-issued currency that is designated as legal tender in its country of issuance through government decree, regulation, or law.*

*) *The term **"Transmission"** means the transfer, by or through a third party, of Virtual Currency from one Person to another Person, including the transfer from the account or storage repository of one Person to the account or storage repository of another U.S. Person;*

*) *The term **"Virtual Wallet"** means the addresses of an account that secures, stores, holds, transfers, by receiving and sending virtual currency.*

g) The term **"Financial Institution"** means a Custodial Institution, a Depository Institution, an Investment Entity, ~~or~~ a Specified Insurance Company~~.~~, *or a Virtual Wallet Entity.*

h) The term **"Custodial Institution"** means any entity that holds, as a substantial portion of its business, financial assets for the account of others. An entity holds financial assets for the account of others as a substantial portion of its business if the entity's gross income attributable to the holding of financial assets and related financial services equals or exceeds 20 percent of the entity's gross income during the shorter of: (i) the three-year period that ends on December 31 (or the final day of a non-calendar year accounting period) prior to the year in which the determination is being made; or (ii) the period during which the entity has been in existence.

i) The term **"Depository Institution"** means any entity that accepts deposits in the ordinary course of a banking or similar business.

j) The term **"Investment Entity"** means any entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities or operations for or on behalf of a customer:

(1) trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;

(2) individual and collective portfolio management; or

(3) otherwise investing, administering, or managing funds or money on behalf of other persons.

This subparagraph 1(j) shall be interpreted in a manner consistent with similar language set forth in the definition of "financial institution" in the Financial Action Task Force Recommendations.

*\) *The term* ***"Virtual Wallet Entity"*** *means any entity that secures, stores, holds or maintains the virtual currency of others, or any entity that conducts the following activity.*

(1) receiving, sending or facilitating transmission of Virtual Currency;

(2) buying and selling Virtual Currency as a customer business;

(3) performing retail conversion services, including the conversion or exchange of Fiat Currency or other value into Virtual Currency, the conversion or exchange of Virtual Currency into Fiat Currency or other value, or the conversion or exchange of one form of Virtual Currency into another form of Virtual Currency; or

(4) controlling Virtual Currency.

s) The term **"Financial Account"** means an account maintained by a Financial Institution, and includes:

(1) in the case of an Entity that is a Financial Institution solely because it is an Investment Entity, any equity or debt interest (other than interests that are regularly traded on an established securities market) in the Financial Institution;

(2) in the case of a Financial Institution not described in subparagraph 1(s)(1) of this Article,

> any equity or debt interest in the Financial Institution (other than interests that are regularly traded on an established securities market), if (i) the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to U.S. Source Withholdable Payments, and (ii) the class of interests was established with a purpose of avoiding reporting in accordance with this Agreement; and
> (3) any Cash Value Insurance Contract and any Annuity Contract issued or maintained by a Financial Institution, other than a noninvestment-linked, nontransferable immediate life annuity that is issued to an individual and monetizes a pension or disability benefit provided under an account that is excluded from the definition of Financial Account in Annex II.
> *(4) in the case of a Virtual Wallet Entity that is assigned a virtual address, which is secured, held and stored by a virtual wallet entity, and used to receive or facilitate a virtual transmission.*[230]

B. Commentary

Including "virtual currency" in the "Definitions" section of the agreement is important to help interpreters understand what is virtual currency and indicate that virtual currency should be reported.[231] The term "digital units" is proper because it encompasses a variety of virtual currency regardless of the kind and how it is measured.[232] "Of exchange or form of digitally stored value" includes both virtual currency used for

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230 *See* MODEL 1A AGREEMENT, *supra* note 111 (providing the regular text language). Italicized provisions are the contributions of the author. Added language is based on the New York Codes, Rule and Regulations. N.Y. COMP. CODES R. & REGS. tit 23, § 200.2 (e), (o), (p)(1)–(2), (q) (2015). Section K through R of the FATCA agreement will remain the same and therefore are not included.

231 *See supra* Part II.A (noting that there are many types of digital currencies: centralized virtual currencies, virtual prizes from games, and airline miles, etc.). Virtual currency is also used by legislators and agencies to describe cryptocurrencies. *See supra* note 2 and accompanying text (listing different state and federal agencies describing cryptocurrencies as virtual currency).

232 *See supra* Part II.A (naming different types of virtual currency, such as Bitcoin, Litecoin, and Dogecoin, among others).

transactions and those used for investments.[233] Definitions such as "fiat currency" and "transmission" were included to supplement comprehension of "virtual currency" and "virtual wallet entity."[234]

Although virtual wallet entities share some characteristics with the other defined financial institutions, it is unique enough to warrant its own category.[235] The definition added includes more than just a virtual wallet provider because virtual entities are involved in different types of activities.[236] As domestic and abroad regulations emerge, including other activities will ideally provide full coverage in preparation for future issues.[237]

The term "virtual wallet" is essential because it encompasses the address keys, which makes wallets the account equivalent of a virtual wallet entity.[238] The virtual community considers these addresses to be the starting and ending mark of a transaction permitting the government to know the units brought in and taken out of the address.[239] Foreign financial institutions would also report to the IRS the public address of the account holder, under the model agreement at Article 2 (2)(2).[240]

The analysis does not make the proposal moot because one can interpret that the virtual market can be included or excluded in the FATCA.[241] Merely, it highlights that the government is more inclusive

233 *See supra* Part III.B.3 (observing that the IRS can consider virtual currency as both types of assets under the definitions provided).

234 *See supra* Part IV.A (using supplementary definitions to help the reader comprehend the terms used in other definitions).

235 *See supra* Part III.B.1 (finding that a virtual wallet provider is the virtual equivalent of a financial institution).

236 *See Choose Your Bitcoin Wallet, supra* note 63 (noting that wallet providers offer different services from one another); *How to Store Your Bitcoins, supra* note 52 (listing different types of wallets providers).

237 *See* LAW LIBRARY OF CONG., *supra* note 66 (organizing the laws of the virtual market from foreign jurisdictions and revealing that some countries do not regulate, some countries regulate, and some countries ban virtual currency); Farber et al., *supra* note 66 (outlining foreign jurisdictions and their laws regarding virtual currency).

238 *See supra* note 43 and accompanying text (revealing that virtual wallets are where virtual currencies are added or withdrawn).

239 *See* FRANCO, *supra* note 59, at 8–9 (noting that Bitcoin addresses are used to identify users and record transactions between users).

240 *See* MODEL 1A AGREEMENT, *supra* note 111 ("the account number (or functional equivalent in the absence of an account number)"). This number could include the virtual address.

241 *See supra* Part II.D (noting that there is an inconsistent consensus of whether the FATCA can or cannot apply to the virtual market); *supra* Part III (determining that one could interpret the FATCA reporting requirements to include virtual currencies without making changes to the model agreements).

than exclusive when it comes to determining tax liability.[242] Without including this language in the agreement, partnering nations would not require virtual currency providers to report U.S. person's virtual wallet accounts. If foreign governments regulate virtual wallet entities like the United States, they have an ability to request compliance with the FATCA information gathering.[243]

There are restrictions in the language of the law that cannot regulate all virtual currency.[244] The most obstructive limitation is that the FATCA applies to "foreign" financial institution with "foreign" accounts holding "foreign" assets.[245] This detail disqualifies any domestic financial institutions.[246] Furthermore, the FATCA does not affect institutions that do not want to disclose this information to the government regardless of the penalties incurred.[247] The FATCA constrains accounts reported by imposing a $50,000 minimum requirement.[248] Setting such a limit is necessary to prevent overburdening the system, but targets fewer people.[249]

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242 *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (statement of Sen. Levin) (reiterating that the tax evasion concern is regarding assets held in foreign institutions).

243 *See* LAW LIBRARY OF CONG., *supra* note 66 (compiling foreign jurisdictions laws regarding virtual currency); Farber, *supra* note 66 (charting the different jurisdictions and the laws regulating the virtual market).

244 *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (statement of Sen. Levin) ("Certainly this legislation will not end tax avoidance or money laundering . . . . [T]his legislation is not a silver bullet."); *supra* Part II.A.1 (discussing the invisible nature of virtual currency).

245 *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (declaring that the tax evasion concern is regarding assets held in foreign institutions).

246 *Id.* Levin indicates that the purpose of the FATCA is to compel foreign banks to disclose the American account holders' information. *Id.* However, the government will still attempt regulation of virtual currency through licensing as money transmitters. *See generally* FIN. CRIMES ENFORCEMENT NETWORK, *supra* note 2, at 1 (clarifying that a virtual currency administrator and exchanger, as defined in guidance, is considered money service business and is regulated).

247 *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (statement of Sen. Levin) ("[This Act] will not affect banks willing to continue to conceal their U.S. account holders despite the penalties that carries a significant loophole for tax dodgers and the foreign banks that assist them . . . ."). *But see* Gruber, *supra* note 3, at 183 n.304 (identifying that BitInstant voluntarily complied with the Bank Secrecy Act by requiring the exchangers to provide information "to maintain BitInstant compliance with applicable laws that require BitInstant to verify that its Services are not being used for illegal purpose to, for example, facilitate in money laundering or the funding of terrorism"). Gruber asserts that companies are willing to comply to avoid criminal sanctions. *Id.* at 182. *See also* Reutzel, *supra* note 66, (pointing out that "[e]ven before the partnership, users of Bitcoin-Central had to provide identification to a bank to deposit into the Bitcoin exchange through wire transfer").

248 *See* 26 U.S.C. § 6038D(a) (2012) ("[W]ith respect to each such asset if the aggregate value of all such assets exceeds $50,000 (or such higher dollar amount as the Secretary may prescribe).").

249 *See supra* Part II.C.4 (revealing that the FATCA is estimated to be burdensome and expensive).

Regardless of the limitations of the FATCA, the nature of virtual currency further weakens the authority of the regulation.[250] For most foreign financial institutions, compliance with the FATCA is compulsory because those that do not comply are subject to penalties.[251] However, virtual wallet providers may not have anything to gain or lose from complying; therefore, rendering it pointless.[252] Dai and Sakamoto invented virtual currency so that a government could not regulate it, but that is erroneous.[253] Any virtual currency holder does not have to hold the funds in an online virtual wallet, making those funds beyond the scope of the FATCA.[254] In addition, there are few virtual currency users and even fewer high value accounts.[255]

Although it seems impractical to modify such agreements after considering the limitations, implementing the proposed requirements means that the parties may be accountable to report and therefore be subject to penalties if they do not.[256] Offshore tax evasion is a never ending struggle that requires the government to improve laws to reduce evaders' efforts. The FATCA is already implemented so adding the language would not make it arduous to apply. Even though the amendments do not reach far, inclusion of the amendments entirely benefits the IRS.

V. CONCLUSION

On the onset of vast virtual crime, the United States can be prepared to win the battle. As different governments regulate virtual currency, the United States should require virtual wallet providers to gather and share information about their account holders. The FATCA is an appropriate vehicle to reduce tax evasion and it is broad enough to encompass a narrow virtual market. Therefore, the IRS should force foreign virtual

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250 *See supra* Part II.A.1 (establishing that virtual currency was created to prevent government and intermediary intervention).

251 *See generally* Behrens, *supra* note 93, at 205 (implying that the United States is "bullying" other countries to comply with the FATCA).

252 *See supra* Part II (identifying the kinds of withholdings and describing the e-wallet provider business).

253 *See* Plassaras, *supra* note 27, at 383 (restating the intentions of Dai and Wei were to avoid government intervention). *But see supra* Part II.B.2 (recognizing the government regulates virtual currency by requiring exchanges to be licensed and taxing virtual currency as property).

254 *See supra* Part II.A.3 (identifying other methods of storing virtual currency).

255 *See* Rob Wile, *927 People Own Over Half of All Bitcoin*, BUS. INSIDER (Dec. 10, 2013), http://www.businessinsider.com/927-people-own-half-of-the-bitcoins-2013-12 [http://perma.cc/94TK-C8RC] (showing that forty-seven individuals have over $10,000 in Bitcoins).

256 *See supra* Part II.C.1 (noting that governments and institutions that do not comply with the FATCA reporting are penalized).

wallet providers to report virtual wallet information of its American account holders. The IRS should amend the model agreements to directly include the virtual market and expand control over virtual wallet entities so that the FATCA reporting obligations are clear. As a consequence to this change, the United States would have to modify the agreements currently enforced. Although it is not a "silver bullet," it is a step in the right direction in preventing an invasion of tax evasion in the United States.[257]

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[257] *See* 156 Cong. Rec. S1635 (daily ed. Mar. 17, 2010) (statement of Sen. Levin) (admitting that the FATCA will not completely eliminate tax avoidance, or money laundering because it "is not a silver bullet").

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