The Cryptonite to Crypto's Regulatory Plight: Evaluating the Use of Mark-to-Market Taxation as a Form of Cryptocurrency Regulation

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I. PRESENTATION OF ISSUE

The number of cryptocurrency investors more than doubled within the first six months of 2021.[1] As the name suggests, cryptocurrencies ("crypto") were intended to be used as a form of currency to exchange for goods and services.[2] Despite its original purpose, however, cryptocurrencies have gained

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[1] CRYPTO.COM, *Measuring Global Crypto Users: A Study to Measure Market Size Using On-chain Metrics* (July 2021), https://crypto.com/images/202107_DataReport_OnChain_Market_Sizing.pdf.

[2] Josephine Shawver, *Commodity or Currency: Cryptocurrency Valuation in Bankruptcy and the Trustee's Recovery Powers*, 62 B.C. L. REV. 2013, 2014–15 (2021).

popularity as both a speculative investment and a medium of exchange for cyber-crime. In September of 2021, the Securities Exchange Commission (S.E.C.) issued a warning regarding the scams and fraud surrounding cryptocurrencies.[3] Additionally, President Biden's administration recently called on Congress to research new methods of regulating cryptocurrency.[4] This new property/currency hybrid leaves governments around the globe wondering how to best regulate this elusive digital asset.

The Internal Revenue Service (IRS) has settled on treating cryptocurrency as a capital asset for tax purposes.[5] On April 14, 2014, the IRS released Notice 2014-21, which states that cryptocurrency would be treated as property for federal tax purposes despite its currency-like characteristics.[6] Beginning in 2020, IRS Form 1040 asks individual taxpayers whether they engaged in crypto transactions during the previous year.[7] Taxpayers will be subject to capital gains taxes on their crypto transactions as they would with traditional capital assets like stocks.

While mostly reserved for financial institutions, I.R.C. § 475(a)(2) requires an investor to recognize gains and losses on a security held at the end of a taxable year as if it was "sold for its fair market value on the last business day of such taxable year."[8] This form of reporting is known as the mark-to-market method of taxation and involves a taxpayer making a uniform payment on gains that were not necessarily realized within the taxable year.

This Note will address whether the use of mark-to-market taxation of cryptocurrency would be an effective and practical tool to regulate and control the use of cryptocurrency as a speculative investment and medium of exchange for illicit activities. This Note will compare I.R.C. § 475 with traditional capital gains reporting, analyze the potential advantages and drawbacks for both tax administrators and taxpayers, and address how the United States and other governments which apply similar tax systems could benefit from the implementation of this tax.

This Note will open with an introductory background on cryptocurrency and blockchain technology.[9] The following section will introduce the concept of mark-to-market taxation and its current use in the United States tax system.[10]

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[3] *Digital Asset and "Crypto" Investment Scams – Investor Alert*, SEC. EXCH. COMM'N (Sept. 1, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/digital-asset-and-crypto-investment-scams-investor-alert.

[4] Troy Newmyer, *Biden Administration Calls on Congress to Take the Lead Regulating Stablecoins*, WASH. POST (Nov. 1, 2021, 3:00 PM), https://www.washingtonpost.com/business/2021/11/01/stablecoin-crypto-regulation/.

[5] I.R.S. Notice 2014-21, 2014-16 I.R.B. 938, https://www.irs.gov/pub/irs-drop/n-14-21.pdf.

[6] *Id.*

[7] I.R.S. *Form 1040 (2020)*, https://www.irs.gov/pub/irs-pdf/f1040.pdf.

[8] I.R.C. § 475.

[9] *See infra* Part II.

[10] *See infra* Part III.

Following these backgrounds, this Note will discuss how the application of the mark-to-market tax system on cryptocurrency gains could discourage cybercrime, reduce market volatility, and raise government revenues.[11] Following the discussion, this Note will analyze critiques such as constitutional issues, funding issues, as well as alternate methods of regulation.[12] This Note will then conclude with a recommendation.[13]

II. BACKGROUND ON CRYPTOCURRENCY

Cryptocurrencies are digital assets used as a medium of exchange.[14] Originally defined in 2008 as a peer-to-peer electronic cash system,[15] there is no central authority to manage the creation or circulation of the cryptocurrency supply.[16] Instead, the general ledger of transactions is dispersed amongst users' computers across the globe in what is referred to as a "decentralized ledger."[17] A coin's intrinsic value is derived from the computing power and electricity cost required to maintain the decentralized ledger.[18] Cryptocurrencies are purely virtual, with no physical coins or notes in circulation.[19] There are thousands of different cryptocurrencies available today, with the three most prominent being Bitcoin, Ethereum, and Stellar.[20]

The decentralized ledger uses blockchain technology to record and verify transactions.[21] Blockchain technology, a method of database maintenance, protects against corruption by distributing identical copies of a database across an entire network.[22] The ledger of stored data is referred to as a "chain" and for new data to be added to the chain, each independent computer must verify the data.[23] Adding new transactions to the chain requires computing power

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[11] *See infra* Part IV.

[12] *See infra* Part V.

[13] *See infra* Part VI.

[14] Kate Ashford & John Schmidt, *What is Cryptocurrency?*, FORBES (Dec. 18, 2020, 12:27 AM), https://www.forbes.com/advisor/investing/what-is-cryptocurrency/.

[15] Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN, https://bitcoin.org/bitcoin.pdf.

[16] Ashford & Schmidt, *supra* note 14.

[17] *Id.*

[18] Andrew Bloomenthal, *What Determines the Price of 1 Bitcoin?*, INVESTOPEDIA (May 19, 2021), https://www.investopedia.com/tech/what-determines-value-1-bitcoin/.

[19] *What To Know About Cryptocurrency and Scams*, FED. TRADE COMM'N, https://www.consumer.ftc.gov/articles/what-know-about-cryptocurrency-and-scams.

[20] John Hyatt, *Decoding Crypto: The 10 Most Popular Cryptocurrencies*, NASDAQ (Aug. 5, 2021, 1:26 PM), https://www.nasdaq.com/articles/decoding-crypto%3A-the-10-most-popular-cryptocurrencies-2021-08-05.

[21] David Rodeck & Benjamin Curry, *What Is Blockchain?*, FORBES (Apr. 28, 2022, 1:16 PM), https://www.forbes.com/advisor/investing/what-is-blockchain/.

[22] *Id.*

[23] *Id.*

and electricity, which can be costly. Computers are rewarded with new amounts of a blockchain's cryptocurrency to compensate for the effort required in recording new transactions.[24] "Mining" refers to the process of using computers to participate in blockchain transaction verification.[25]

Dedicated exchanges where users can purchase, sell, and store cryptocurrency exist similarly to other financial assets.[26] Websites such as Coinbase allow users to register for an account where they can create a virtual "wallet" in which they are able to store their crypto holdings (similar to a checking account).[27] After creating a wallet, users can access Coinbase's trading platform to purchase, sell, transfer, or exchange cryptocurrencies.[28] At time of writing, Coinbase alone boasts more than 68 million registered users with over $462 billion being traded on the platform quarterly.[29]

New forms of digital assets, such as stablecoins and non-fungible tokens ("NFT's"), also fall under the collective "crypto" umbrella term, recently supplementing traditional cryptocurrencies, such as Bitcoin and Etheruem. Stablecoins are a form of cryptocurrency which are pegged to the value of a fiat currency like the U.S. dollar or British pound.[30] Stablecoins maintain a constant price through the holding of reserve assets and algorithms that control the circulation of coins.[31] While gains realized on the sale of stablecoins are subject to capital gains taxes like other cryptocurrencies, a stablecoin investor typically never realizes any gains from the sale of stablecoins due to their consistent price.[32]

NFT's are non-fungible images with unique identification codes.[33] These images often portray real world property like artwork and real estate.[34] NFT's can be bought and sold on dedicated exchanges.[35] In 2021, an NFT titled "EVERYDAYS: THE FIRST 5000 DAYS" was sold in a Christie's auction for

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[24] *Id.*

[25] Jurica Dujmovic, *Opinion: How a Beginner Can Try Their Hand at Cryptocurrency Mining*, MARKET WATCH (May 7, 2021, 3:35 PM), https://www.marketwatch.com/story/how-a-beginner-can-try-their-hand-at-cryptocurrency-mining-11620416142.

[26] *See* COINBASE, https://www.coinbase.com/ (last visited Sept. 12, 2022).

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] Adam Hayes, *Stablecoin*, INVESTOPEDIA (May 11, 2022), https://www.investopedia.com/terms/s/stablecoin.asp.

[31] *Id.*

[32] Zac McClure, *How Are Stablecoins Taxed?*, TOKENTAX (Aug. 17, 2022), https://tokentax.co/blog/how-are-stablecoins-taxed/#:~:text=Will%20you%20pay%20taxes%20on,tangible%20capital%20gain%20or%20loss.

[33] Rakesh Sharma, *Non-Fungible Token Definition: What It Means and How It Works*, INVESTOPEDIA (June. 22, 2022), https://www.investopedia.com/non-fungible-tokens-nft-5115211.

[34] *Id.*

[35] *Id.*

$69.3 million.[36] This marked Christie's first ever sale of a completely digital artwork.[37] Just like traditional cryptocurrencies and stablecoins, gains realized from the sale of NFTs are also subject to capital gains tax.[38]

So, what is the point of buying and holding cryptocurrency? Today, there are two main reasons why people hold cryptocurrency: to purchase goods and to hold as an investment.[39] With more than 15,000 businesses worldwide[40] and 2,300 businesses in the U.S.[41] accepting cryptocurrency as of 2020, transactions involving crypto are becoming increasingly common. Consumers can now purchase Starbucks coffee[42] as well as a Tesla[43] with Bitcoin.

Although daily transactions with cryptocurrencies are gaining popularity, many crypto holders purchase coins solely for investment purposes. Valued at

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[36] *Online Auction 20447 Beeple | The First 5000 Days*, CHRISTIE'S (Mar. 11, 2021), https://onlineonly.christies.com/s/beeple-first-5000-days/beeple-b-1981-1/112924.

[37] Andrew Hayward, Stephen Graves & Daniel Phillips, *The Top 15 Most Expensive NFTs Ever Sold*, DECRYPT (Feb. 21, 2022), https://decrypt.co/62898/most-expensive-nfts-ever-sold.

[38] *What Is the Tax Treatment of Non-Fungible Tokens? Are NFTs Taxable?,* COINTAXLIST: BLOG (Apr. 17, 2022), https://cointaxlist.com/blog/what-is-the-tax-treatment-of-non-fungible-tokens-nft.

[39] Kevin Voigt & Andy Rosen, *Cryptocurrency: Definition and Current Prices*, NERDWALLET (June 13, 2022), https://www.nerdwallet.com/article/investing/cryptocurrency-7-things-to-know.

[40] Ryan, *Who Accepts Bitcoin and Ether Cryptocurrencies*, CURRENCY EXCH. INT'L: BLOG POSTS (May 12, 2021), https://www.ceifx.com/news/who-accepts-bitcoin-and-ether-cryptocurrencies.

[41] *The Rise of Using Cryptocurrency in Business*, DELOITTE https://www2.deloitte.com/us/en/pages/audit/articles/corporates-using-crypto.html.

[42] Jamie Redman, *Starbucks Customers Can Now Pay with Bitcoin via Bakkt's Digital Wallet App*, BITCOIN.COM (Apr. 5, 2021), https://news.bitcoin.com/starbucks-customers-can-now-pay-with-bitcoin-via-bakkts-digital-wallet-app/.

[43] Julie Gerstein, *Elon Musk Announces on Twitter that You Can Now Buy a Tesla with Bitcoin*, BUSINESS INSIDER (Mar. 24, 2021), https://www.businessinsider.com/elon-musk-tweets-you-can-buy-a-tesla-with-bitcoin-2021-3.

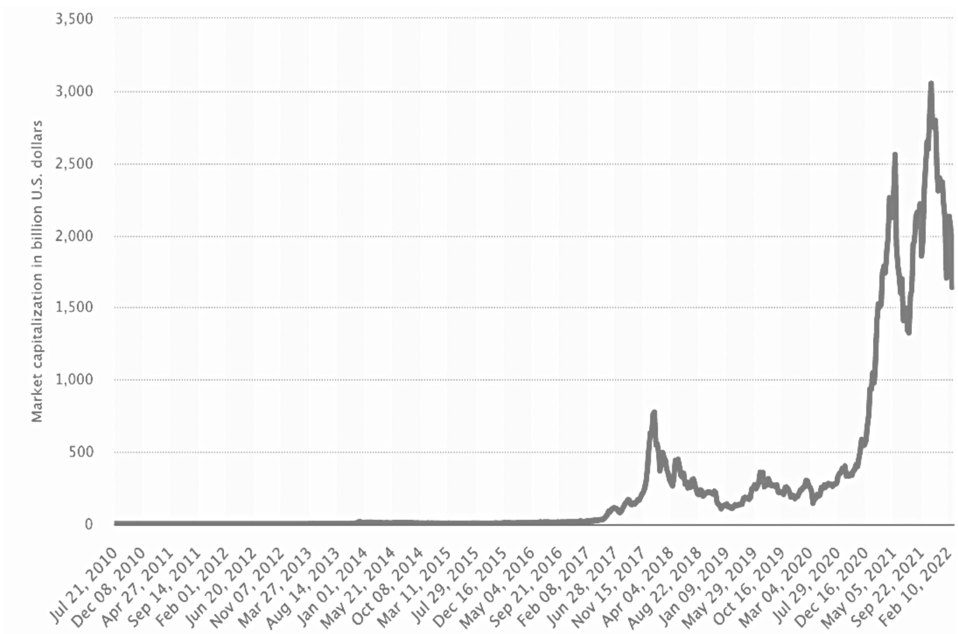

Fig. 1

approximately ten cents per coin in October of 2010,[44] one Bitcoin is now worth more than $45,000.[45] This exponential growth over the past decade has led the cryptocurrency market to be "dominated by speculative trading."[46] The graph above shows the rapid growth in cryptocurrency market capitalization since 2010.[47]

Despite the increase in cryptocurrency investment, there is currently little regulation in the United States that specifically addresses cryptocurrency.[48] Because cryptocurrency combines properties of currency and commodity, it is sometimes an exercise in futility to decide which traditional, pre-cryptocurrency-era regulations are applicable to these digital assets. Money

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[44] Carmen Reinicke, *Bitcoin Hits Another Record. Here's How Much You'd Have If You Invested $100 in 2009*, CNBC (Feb. 12, 2021, 8:03 AM), https://www.cnbc.com/2021/02/12/how-much-youd-have-today-if-you-invested-100-in-bitcoin-in-2009.html.

[45] *See* COINBASE, https://www.coinbase.com/price/bitcoin (last visited Sept. 12, 2021).

[46] Nathan Reiff, *Why Should Anyone Invest in Crypto?*, INVESTOPEDIA (Aug. 24, 2021), https://www.investopedia.com/tech/question-why-should-anyone-invest-crypto/#:~:text=Another%20common%20reason%20to%20invest,dilute%20their%20value%20through%20inflation.

[47] *Overall Cryptocurrency Market Capitalization per week from July 2020 to March 2022*, STATISTA, https://www.statista.com/statistics/730876/cryptocurrency-maket-value/ (last visited Mar. 2022).

[48] Alma Angotti & Anne Marie Minogue, *Risks and Rewards: Blockchain, Cryptocurrency and Vulnerability to Money Laundering, Terrorist Financing and Tax Evasion*, WESTLAW J. BANK & LENDER LIAB., Nov. 26, 2018, 2018 WL 6037317.

launderers, tax evaders, and terrorist financiers have all been able to take advantage of this regulatory gray area.[49] Tax evaders, for example, can use the decentralized ledger to hide or divert income. The dispersed nature of the decentralized ledger complicates due diligence activities resulting in a favorable environment for money laundering and other illicit activities.[50]

One of the most famous examples of criminal activity involving cryptocurrency was the Silk Road operation.[51] In 2011, a website, which facilitated the trade of illegal goods, named Silk Road was launched.[52] All transactions on Silk Road were conducted using Bitcoin.[53] By sending and receiving Bitcoin with random addresses, this online marketplace created a level of anonymity which made identifying any involved party almost impossible.[54]

In the United States, a few state-level governments are beginning to embrace, or at least recognize, the growth of cryptocurrency. Wyoming and Nebraska, for instance, have created special banking charters for institutions that want to offer cryptocurrency-related services.[55] In Wyoming, institutions with these charters can receive deposits and provide fiduciary asset management services.[56] These charters come with a caveat, however, in that they prohibit the institution from lending and are required to keep all deposits in cash or other liquid assets.[57]

While these new charters show that legislatures are aware of the popularity of crypto, they also represent the skepticism surrounding it. The Nebraska charter, introduced in May 2021, requires chartered institutions to make certain disclosures to customers regarding the volatility of cryptocurrency.[58] The Nebraska charter also requires every cryptocurrency held to be "backed by a dollar in a federally insured account."[59] These required cautionary measures aren't so much an endorsement of the use of

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[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] Alma Angotti & Anne Marie Minogue, *Risks and Rewards: Blockchain, Cryptocurrency and Vulnerability to Money Laundering, Terrorist Financing and Tax Evasion*, WESTLAW J. BANK & LENDER LIAB., Nov. 26, 2018, 2018 WL 6037317.

[54] *Id.*

[55] Penny Crosman, *States Take Lead on Crypto Bank Charters and Digital Asset Rules*, AM. BANKER (Oct. 18, 2021, 9:00 PM), https://www.americanbanker.com/news/states-take-lead-on-crypto-bank-charters-and-digital-asset-rules.

[56] *Id.*

[57] *Id.*

[58] *Id.*

[59] *Id.*

cryptocurrency as they are an attempt to provide citizens with a safer way to hold their crypto than stashing it away in a private digital wallet.[60]

III. BACKGROUND ON MARK-TO-MARKET TAXATION

In most nations that follow a form of free-market economics, taxes are based on several common principles. One of these principles is known as the "ability to pay" principle, which requires that a taxpayer only be taxed on income that they have recognized.[61] The ability to pay principle states that a taxpayer should not owe taxes on a transaction in which he or she did not receive any property.[62] This principle manifests itself throughout the Internal Revenue Code, such as in § 1001(a) in which an asset's appreciation is only taxed upon "disposition of the property."[63]

Despite this long-ingrained principle of "ability to pay," academics and industry professionals have long considered mark-to-market taxation to be the ideal form of taxation, as it measures true economic income as opposed to realized income.[64] Mark-to-market taxation is a method of taxing an asset's appreciation without requiring realization.[65] In the world of tax, the term "realization" refers to the direct cash flow an investor receives after selling an asset.[66] Any appreciation in an investor's asset is "unrealized" until it is sold.[67] Traditional taxing methods which follow the ability to pay principle require an individual taxpayer to first sell a security before that security's appreciation is subject to tax. Under mark-to-market taxation, an asset is taxed based on the asset's change in value during a certain period regardless of whether it was sold.[68] The term mark-to-market derives from the accounting term "marking-to-market" in which an asset is valued at its current market value.[69]

Mark-to-market is no longer purely theoretical and has manifested itself throughout the Internal Revenue Code. In 1997, Internal Revenue Code

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[60] *How to Store Cryptocurrency Safely in 2021*, CRYPTONEWS (2021), https://cryptonews.com/guides/how-to-store-cryptocurrency-safely.htm (explaining the different types of digital wallets that crypto holders can use to store their cryptocurrency).

[61] Will Kenton, *Ability to Pay*, INVESTOPEDIA (Sept. 30, 2020), https://www.investopedia.com/terms/a/abilitytopay.asp.

[62] *Id.*

[63] 26 U.S.C. § 1001(a).

[64] Yoram Keinan, *Book Tax Conformity for Financial Instruments*, 6 FLA. TAX REV. 676 (2004).

[65] Greg Leiserson & Will McGrew, *Taxing Wealth by Taxing Investment Income: An Introduction to Mark-to-Market Taxation*, WASH. CTR. FOR EQUITABLE GROWTH (Sept. 11, 2019), https://equitablegrowth.org/taxing-wealth-by-taxing-investment-income-an-introduction-to-mark-to-market-taxation/.

[66] C. EUGENE STEUERLE, THE RELATIONSHIP BETWEEN REALIZED INCOME AND WEALTH 1 (1982), https://www.irs.gov/pub/irs-soi/13pwcrealwealth.pdf.

[67] *Id.*

[68] Ari Glogower, *Comparing Capital Income and Wealth Taxes*, 48 PEPP. L. REV. 875, 884 (2021).

[69] *Mark-to-Market (MTM)*, TAX FOUNDATION, https://taxfoundation.org/tax-basics/mark-to-market-mtm/.

Section 475 ("I.R.C. 475") became effective.[70] I.R.C. 475 allows dealers in securities to elect the mark-to-market form of taxation for certain securities they hold.[71] Upon electing the mark-to-market method under I.R.C. 475, the dealer will report any gains on the securities "as if such security were sold for its fair market value on the last business day of such taxable year."[72] Although the taxpayer has not realized any income from the security, the security is still subject to tax on the unrealized appreciation that has accumulated as of the end of the taxable year.

As of this writing, I.R.C. 475 is only available to dealers in securities who elect to be taxed on a mark-to-market basis.[73] Congress has yet to explain its reasoning for limiting the election to only securities dealers, but it is presumably:

> (a) because of discomfort with nonrealization accounting (i.e., for historical reasons); (b) in order to protect taxpayers from being subject to taxes they could not afford to pay (i.e., for paternalistic reasons); or (c) because Congress was worried that, at the margins, there would be tax arbitrage available if investors were permitted to mark their securities and commodities investments to market.[74]

While points "(a)" and "(c)" are beyond the scope of this Note, the concern giving rise to "(b)" is a reason to enact mark-to-market taxation on cryptocurrency, and will be addressed later in the discussion.

In the United States, mark-to-market taxation is also used when calculating the tax liability of expatriates. Introduced in 2008, the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) created an "exit tax" for individuals expatriating from the United States.[75] Under § 877A(a)(1) of the Internal Revenue Code, an individual expatriating from the United States is subject to a final tax on all their U.S. sourced income.[76] Under § 877A(a)(1), when calculating the taxes owed on an expatriate's property, the property will be treated is if it had been sold "on the day before the expatriation date for its fair market value."[77] This tax on unrealized gain results in a mark-to-market form of taxation in which property's appreciation is subject to tax regardless of whether a realization transaction has occurred.

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[70] I.R.C. § 475

[71] I.R.C. § 475(a)(2)

[72] I.R.C. § 475(a)(2)(A)

[73] *See* I.R.C. § 475(a)

[74] Samuel D. Brunson, *Taxing Investors on A Mark-to-Market Basis*, 43 LOY. L.A. L. REV. 507, 532 (2010).

[75] Gary Forster & J. Brian Page, *Expatriation from the United States: The Exit Tax*, 94 FLA. B.J. 60, 60 (2020).

[76] *Id.*

[77] 26 U.S.C. § 877A(a)(1).

IV. DISCUSSION

A. Leveraging the Discouraging Effects of Mark-to-Market Taxation

With cryptocurrency becoming more common for consumer transactions, speculative investments, and the facilitation of cyber-crime, governments are wondering how to best regulate crypto use.[78] Due to being such a volatile asset, cryptocurrency can be dangerous for consumers to hold either for daily use or long-term speculation.[79] Additionally, since cryptocurrency transactions are mostly anonymous, it has become a go-to medium of exchange for drug purchases, money laundering, and investment scams.[80]

One way for governments to regulate unwanted cryptocurrency use while also generating revenue is the use of mark-to-market taxation. By using mark-to-market taxation, taxpayers would potentially be liable for capital gains tax on their crypto holdings regardless of whether they realized any gains through sale.[81] This would encourage individuals to think twice about holding cryptocurrency for either consumer purchases or speculative investments. It would also allow governments to generate revenue from coins that have skyrocketed in value over the past decade.[82]

Governments have historically avoided mark-to-market taxation of property for two reasons, the first being to encourage long-term investing.[83] Under current capital gains taxation methods, gains from investments are only taxed once realized.[84] In the United States, investments that are held for a minimum of one year are classified as "long-term" investments.[85] Realized gains on long-term investments are taxed at a lower, preferential rate than

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78 Ryan Haar, *U.S. Crypto Regulation Talks Are Heating Up, With Three Major Themes Emerging. Here's What They Mean for Investors*, NEXTADVISOR (Aug. 12, 2021), https://time.com/nextadvisor/investing/cryptocurrency/crypto-regulation-talks-heat-up/#:~:text=News%20This%20Week-,Cryptocurrency%20Crime%20and%20Tax%20Evasion,asset%20trades%20%E2%80%94%20like%20cryptocurrency%20exchanges; Ryan Haar, *U.S. Officials Send Mixed Messages on Crypto Regulation. Here's What It All Means for Investors,* TIME: NEXTADVISOR (Apr. 18, 2022), https://time.com/nextadvisor/investing/cryptocurrency/crypto-regulation-talks-heat-up/#:~:text=News%20This%20Week-,Cryptocurrency%20Crime%20and%20Tax%20Evasion,asset%20trades%20—%20like%20cryptocurrency%20exchanges.

79 *See* Greg Khojikian, *The Biggest Risks of Investing in Bitcoin*, FORBES (Jun. 17, 2021), https://www.forbes.com/sites/forbesbusinesscouncil/2021/06/17/the-biggest-risks-of-investing-in-bitcoin/?sh=42316ef24afd.

80 SEC. EXCH. COMM'N*, supra* note 3.

81 Leiserson & McGrew, *supra* note 65.

82 COINBASE, *supra* note 45.

83 *The Tax Break-Down: Preferential Rates on Capital Gains*, COMM. FOR A RESPONSIBLE FED. BUDGET (Aug. 27, 2013), https://www.crfb.org/blogs/tax-break-down-preferential-rates-capital-gains.

84 26 U.S.C. § 1001.

85 26 U.S.C. § 1222(3).

non-long-term investments which are taxed as normal income.[86] These preferential rates are designed to encourage taxpayers to hold their investments for a longer period of time.[87] In theory, this creates a more stable economy by incentivizing taxpayers to lower their investment turnover.

Imposing a higher[88] tax rate on cryptocurrency gains would serve the same purpose as contractionary policy used by the Federal Reserve to curb growth in an overheating economy. Contractionary policy involves the use of higher interest rates when inflation is deemed to be above a target growth rate.[89] The Federal Reserve imposes these higher interest rates to slow the amount of lending and borrowing taking place in the economy, which in turn reduces the rate of inflation.[90] Since high tax rates have the potential to "discourage investment,"[91] imposing a mark-to-market tax on cryptocurrency could deter speculative investment.

The second major reason why governments have avoided mark-to-market taxation methods is due to liquidity concerns.[92] Liquidity refers to "how easily an asset or shares can be bought or sold on the market at a price that represents its intrinsic value."[93] The more liquid a taxpayer is, the more quickly they can access cash. When using a tax system that imposes a tax liability on an asset's unrealized gains, such as the mark-to-market method, taxpayers may not have the cash on hand to pay for the gains on investments that they haven't sold yet. This lack of liquidity may result in a taxpayer having to sell the asset to pay the taxes if they don't have the available cash to make the payment. Since "an electing taxpayer must pay taxes each year on the increase in the net asset value of her investments—and because, once made, the election cannot be easily revoked—Congress perhaps intended to protect taxpayers from themselves."[94]

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[86] *Topic No. 409 Capital Gains and Losses*, I.R.S., https://www.irs.gov/taxtopics/tc409#:~:text=Limit%20on%20the%20Deduction%20and,Schedule%20D%20(Form%201040).

[87] COMM. FOR A RESPONSIBLE FED. BUDGET, *supra* note 83.

[88] For a year in which a taxpayer does not sell their cryptocurrency holdings, the effective tax rate will be higher than under the current realization-based capital gains tax system.

[89] Ali Hussain and Jasmine Suarez, *The Federal Reserve uses Contractionary Monetary Policy to curb Inflation that Accompanies an Overheating Economy,* (July 14, 2022, 9:04AM) https://www.businessinsider.com/what-is-contractionary-monetary-policy.

[90] *Id.*

[91] *How Do Taxes Affect the Economy in the Long Run?,* TAX POLICY CENTER, (May, 2020), https://www.taxpolicycenter.org/briefing-book/how-do-taxes-affect-economy-long-run.

[92] David A. Weisbach, *A Partial Mark-to-Market Tax System*, 53 TAX L. REV. 95, 96 (1999).

[93] Sujaini, *Liquidity*, CLEARTAX, https://cleartax.in/g/terms/liquidity (last visited Aug. 25, 2022).

[94] Samuel D. Brunson, *Taxing Investors on A Mark-to-Market Basis*, 43 Loyola L.A. L. Rev. 507, 534 (2010).

With governments around the world wanting to discourage taxpayers from transitioning from fiat holdings to cryptocurrency use,[95] the mark-to-market method could leverage its "discouraging" effects to achieve government objectives. For example, if Bitcoin experienced a large increase in value over the course of a year, the mark-to-market method would result in a tax liability for that appreciation.[96] Depending on the taxpayer's financial situation, they may have to exit their crypto positions to pay the tax. This exiting of a crypto position and possible discouragement regarding owning crypto for speculative purposes might be what the White House is wanting to achieve as it debates whether "protections are needed for average retail investors purchasing cryptocurrency."[97]

B. Reducing Volatility

When a taxpayer sells a capital asset for less than they originally purchased it for, the taxpayer is entitled to a loss which may be used as a tax deduction.[98] This rule can be manipulated, however, when a taxpayer sells a capital asset for a loss and then immediately repurchases the same asset. In theory, this transaction would result in the taxpayer being allowed to claim a deduction for the asset's decline in value while still retaining control of the asset.[99]

These types of transactions are known as "wash sales."[100] Internal Revenue Code Section 1091 addresses wash sales. I.R.C. § 1091(a) states that if a "substantially identical" asset is sold and then repurchased within 30 days, no "deduction shall be allowed" for the loss realized on the sale of the asset.[101] This provision, in effect, removes any incentive for a taxpayer to quickly sell and repurchase a stock in order to harvest the tax loss.

While I.R.C. § 1091(a) applies to sales involving stocks and securities, it does not include cryptocurrencies.[102] This lack of inclusion means that taxpayers are still incentivized to quickly sell and repurchase cryptocurrency when a drop in price occurs in order to recognize a loss. When investors sell

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[95] *See* Greg Noone, *The Case Against Bitcoin: Why Governments are Cracking Down on Crypto*, TECH MONITOR (May 13, 2021), https://techmonitor.ai/policy/digital-economy/case-against-bitcoin-governments-plan-cryptocurrency-ban (last updated Nov. 1, 2022, 10:12AM) (explaining that governments are averse to citizens' crypto use due to the potential for fraudulent activity and a resulting decrease in effectiveness of government monetary policy).

[96] Greg Leiserson & Will McGrew, *supra* note 65.

[97] Jeff Stein, *White House Reviews 'Gaps' in Cryptocurrency Rules as Bitcoin Swings*, THE WASH. POST (May 25, 2021, 11:21 AM), https://www.washingtonpost.com/us-policy/2021/05/25/biden-bitcoin-crypto-markets/.

[98] *See* 26 U.S.C. § 1001(a).

[99] Hayden Adams, *A Primer on Wash Sales*, CHARLES SCHWAB (Feb. 3, 2021), https://workplace.schwab.com/resource-center/insights/content/a-primer-on-wash-sales.

[100] 26 U.S.C. § 1091.

[101] *Id.*

[102] *Id.*

their holdings anytime the price of cryptocurrency decreases in order to harvest the tax loss, the high number of sell orders will create volatile drops in the cryptocurrency's price.[103]

Volatility refers to the amount by which an asset's prices fluctuate in relation to the asset's average price.[104] A highly volatile asset will experience relatively large price fluctuations in a given period of time, while a low-volatility asset will have relatively small price fluctuations in a given period of time. For most capital assets "the higher the volatility, the riskier the security."[105] One way in which volatility is increased is through large amounts of buy or sell orders occurring at the same time.[106] For example, "when a stock is purchased in large quantities, the stock price or value goes up sharply" and vice versa for sell orders.[107] When dealing with an asset that is not subject to I.R.C. § 1091(a), such as cryptocurrency, investors are incentivized to sell large quantities of crypto at the same time in order to harvest a tax loss. This massive influx of sell orders results in higher price volatility, shifting the price of a cryptocurrency downward in a short period of time and negatively affecting taxpayers that choose to continue holding the cryptocurrency.[108]

Implementing a mark-to-market tax on cryptocurrency would reduce the volatility in the cryptocurrency market that results from tax loss harvesting. Since a mark-to-market tax assesses the value of an asset without requiring a realization transaction, this means that investors are able to recognize a tax loss for the year without having to sell their cryptocurrency positions.[109] The resulting reduction in mass sell-offs and buy-ins reduces volatility, helping to stabilize the price and lower the risk of cryptocurrency investments.

C. Discouraging Cybercrime

On November 1, 2021, a cryptocurrency named Squid (based on the hit Netflix series Squid Game) crashed from a price of $2,800 to $.0007 within minutes.[110] The young cryptocurrency had been founded only one week before the flash crash and left over forty thousand people holding the valueless

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[103] *See* Will Kenton, *Liquidating Market*, INVESTOPEDIA, https://www.investopedia.com/terms/l/liquidating-market.asp (last updated June 30, 2022).

[104] Adam Hayes, *Volatility*, INVESTOPEDIA, https://www.investopedia.com/terms/v/volatility.asp (last updated Aug. 23, 2022).

[105] *Id.*

[106] Chizoba Morah, *Are Stocks with Large Daily Volume Less Volatile?*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/09/daily-volume-volatility.asp#:~:text=There%20is%20a%20relationship%20between,stock%20experiences%20a%20sharp%20decrease (last updated July 25, 2022).

[107] *Id.*

[108] *Id.*

[109] Leiserson & McGrew, *supra* note 65.

[110] John Yoon, *A Cryptocurrency Inspired by 'Squid Game' Crashes*, N.Y. TIMES (Nov. 2, 2021), https://www.nytimes.com/2021/11/02/business/squid-coin-crypto-scam.html.

coins.[111] Following the crash, Squid's website had been removed, its social media pages deleted, and its email addresses no longer accepted messages.[112] This type of scam is known as a "rug pull" in which the developers of a cryptocurrency lure investors into making speculative investments to drive up the price before ultimately withdrawing their funds and running away.[113]

The Squid scam was not an anomaly. The Federal Trade Commission ("FTC") reported that in 2021, seven thousand people lost approximately $80 million in crypto scams.[114] This is a 967% increase over the $7.5 million worth of cryptocurrency lost in scams during 2020.[115] In a May 2021 bulletin, the FTC stated that cryptocurrency scams are often solicited by internet users acting as a victim's friend.[116] A social media account may try to offer a new cryptocurrency investment program or product which requires an investor to send money to a private wallet address.[117] The United Kingdom's National Fraud & Cyber Crime Reporting Centre states that sometimes the investment program will have its own website to make it appear legitimate.[118] Potential investors will sign up for an account which requires them to enter personal details and credit card information.[119] These investment products often guarantee to provide above-average returns.[120]

Cryptocurrency has flourished as a medium of exchange in cybercrime. In addition to scams described above, tax evasion and money laundering are two of the biggest illicit activities involving cryptocurrencies.[121] There are two types of tax evasion: evasion of assessment and evasion of payment.[122] Evasion of assessment is more common and involves the income underreport and

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[111] *Id.*

[112] *Id.*

[113] *What is a Rug Pull?*, ALEXANDRIA, https://coinmarketcap.com/alexandria/glossary/rug-pull.

[114] Julian Dossett, *Coinbase Warns Users of 'Large-Scale' Phishing Threat*, TIME: NEXTADVISOR (Oct. 1, 2021), https://time.com/nextadvisor/investing/cryptocurrency/common-crypto-scams/.

[115] *Id.*

[116] Emma Fletcher, *Cryptocurrency Buzz Drives Record Investment Scam Losses*, FED. TRADE COMM'N (May 17, 2021), https://www.ftc.gov/news-events/blogs/data-spotlight/2021/05/cryptocurrency-buzz-drives-record-investment-scam-losses.

[117] *Id.*

[118] *Cryptocurrency*, ACTION FRAUD, https://www.actionfraud.police.uk/a-z-of-fraud/cryptocurrency (last visited Feb. 13, 2022).

[119] *Id.*

[120] *Digital Asset and "Crypto" Investment Scams – Investor Alert,* U.S. SEC. EXCH. COMM'N (Sept. 1, 2021)*,* https://www.sec.gov/oiea/investor-alerts-and-bulletins/digital-asset-and-crypto-investment-scams-investor-alert.

[121] CYBER-DIGITAL TASKFORCE, U.S. DEP'T JUST., CRYPTOCURRENCY ENFORCEMENT FRAMEWORK 5 (2020)

[122] Shehan Chandrasekera, *Crypto Tax Evasion is a Criminal Offense*, FORBES (Oct. 16, 2020, 9:00 AM), https://www.forbes.com/sites/shehanchandrasekera/2020/10/16/crypto-tax-evasion-is-a-criminal-offense/?sh=548fdbd6125e.

deductions overstatement.[123] Evasion of assessment by the use of cryptocurrency involves "not reporting capital gains from the sale or other disposition of the cryptocurrency, not reporting business income received in cryptocurrency, not reporting wages paid in cryptocurrency, or using cryptocurrency to facilitate false invoice schemes designed to fraudulently reduce business income."[124] For example, the IRS currently requires all consumers to report transactions involving cash over $10,000, but the same rule does not apply to crypto transactions.[125] This loophole allows crypto users to bypass these reports when making purchases with crypto, making it easier to hide realization transactions that may result in tax liabilities.[126]

In April 2021, IRS Commissioner Charles Rettig stated that this lack of reporting requirements for cryptocurrency transactions "contributed to the upwards of $1 trillion every year in unpaid taxes due to the federal government."[127] Rettig also stated that "most crypto virtual currencies are designed to stay off the radar screen" and that Congress must introduce a new legislation addressing this issue.[128]

A recent bipartisan infrastructure bill is attempting to confront this loophole.[129] Under this bill, any party that provides a service in which transfers of cryptocurrency are regularly executed must report said transactions to the IRS.[130] Additionally, the bill would require reporting any transaction over $10,000 to the IRS, similar to the existing rule for cash transactions.[131]

These proposed rules are not without opposition, however, as cryptocurrency lobbyists are actively opposing these potential new reporting requirements.[132] In addition to its lobbying efforts, the crypto industry is preparing to take the fight to the courts, claiming that these new requirements would violate the Fourth Amendment's protections against unreasonable inquiries by the government.[133] Peter Van Valkenburgh of the crypto think

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[123] *Id.*

[124] *Id.*

[125] Greg Iacurci, *Cryptocurrency Poses a Significant Risk of Tax Evasion*, CNBC (May 31, 2021, 8:30 AM), https://www.cnbc.com/2021/05/31/cryptocurrency-poses-a-significant-risk-of-tax-evasion.html.

[126] *Id.*

[127] Chris Matthews, *The Crypto Industry Could Take Tax Fight All the Way to the Supreme Court*, MARKETWATCH (Sept. 24, 2021, 2:43 PM), https://www.marketwatch.com/story/the-crypto-industry-could-take-tax-fight-all-the-way-to-the-supreme-court-11632509009 (last updated Sept. 25, 2021 10:28 AM).

[128] *Id.*

[129] *See Id.*

[130] *Id.*

[131] *Id.*

[132] Matthews, *supra* note 127.

[133] *Id.*

tank *Coin Center* stated that these new reporting requirements "erode the privacy of law-abiding Americans."[134]

Governments have started to notice the loopholes that are being exploited with cryptocurrency, however, as the Government Accountability Office recently recommended that the IRS start to improve its enforcement efforts surrounding the taxation of crypto.[135] The Organization for Economic Development and Cooperation mirrored this sentiment by encouraging tax authorities around the world to focus more on reducing crypto-related tax evasion.[136]

By implementing a mark-to-market system of taxation, a government would be able to impose a potential tax liability on parties who participate in fraudulent transactions that would normally be more difficult to tax while also avoiding the constitutional lawsuits resulting from the bipartisan bill's proposed reporting requirements. Under mark-to-market taxation, the appreciation on a taxpayer's cryptocurrency would be subject to tax whether or not a realization transaction occurred.[137] This way, a taxpayer would not be able to avoid tax liabilities by not reporting realization transactions.

D. Tax Revenue

In addition to regulating the use of crypto, the mark-to-market method will allow governments to generate tax revenue on unrealized gains. The value of crypto has skyrocketed over the past decade, and individuals who have owned Bitcoin for the past five years without selling are now sitting on massive unrealized earnings.[138] Implementing a mark-to-market tax on these coins would allow governments to raise revenue by taxing these unrealized gains.[139]

It would be difficult to determine exactly how much a government could expect to raise annually through a crypto mark-to-market tax. Due to the nature of cryptocurrency, it is almost impossible to precisely estimate the amount of cryptocurrency held by citizens of a certain nation and revenue estimates would depend on factors such as future tax legislation and the overall state of the economy for a certain tax year—both of which are beyond the scope of this Note. For scale, thirteen percent of U.S. taxpayers realized a total of approximately $4.1 billion in Bitcoin gains during 2020.[140]

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[134] *Id.*

[135] Chandrasekera, *supra* note 122.

[136] *Id.*

[137] Leiserson & McGrew, *supra* note 65.

[138] COINBASE, *supra* note 45.

[139] Leiserson & McGrew, *supra* note 65.

[140] Taylor Locke, *Americans Earned Over $4 Billion from Bitcoin in 2020—More Than 3 Times as Much as Investors in Any Other Country*, CNBC (June 9, 2021, 12:55 PM), https://www.cnbc.com/2021/06/09/americans-earned-over-4-billion-from-bitcoin-in-2020.html.

V. ANALYZING CRITIQUES

Implementing a mark-to-market system would pose challenges for both governments and taxpayers across the globe.[141] Even if applied only to cryptocurrency, these changes could potentially affect 100 million people worldwide.[142]

For governments, there will be administrative and political barriers which would need to be addressed before implementing a mark-to-market system of taxation.[143] The main challenges will be how to properly value a taxpayer's crypto holdings during a given taxable year as well as the administrative burden of rolling out such sweeping tax reform. Additionally, any new Internal Revenue Code sections and treasury regulations involving the mark-to-market system in the United States would need to be approved by Congress, which will be politically difficult since this proposed tax could result in middle-class tax increases.

A. Constitutional Issues

One of the stronger arguments against the mark-to-market tax is constitutional and is currently being used to challenge the wealth tax proposed by the Biden administration.[144] The constitutional argument against mark-to-market taxation is based upon the "apportionment requirement" of Article I, Section 2 of the Constitution which states that "direct Taxes shall be apportioned among the several States . . . according to their respective Numbers."[145] Under the apportionment requirement, revenues collected from a tax need to be collected in proportion with the population of each state.[146] The apportionment requirement leads to problems such as higher effective rates in poorer and smaller states.[147]

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[141] Scott Eastman & Chad Qian, *Evaluating Mark-to-Market Taxation of Capital Gains*, TAX FOUND. (Dec. 17, 2019), https://taxfoundation.org/mark-to-market-taxation-of-capital-gains/.

[142] Harry Robertson, *The Estimated Number of Global Crypto Users Has Passed 100 Million—And Boomers are Now Getting Drawn to Bitcoin Too, Reports Find*, MKT. INSIDER (Feb. 25, 2021, 4:50 AM), https://markets.businessinsider.com/news/currencies/crypto-users-pass-100-million-boomers-gen-x-bitcoin-btc-ethereum-2021-2.

[143] Sijbren Cnossen & Lans Bovenberg, *Fundamental Tax Reform in The Netherlands*, 8 Int'l Tax and Pub. Fin. 471 (2001).

[144] Daniel Hemel, *A Wealth Tax is a Good Idea—If We Had a Different Supreme Court*, THE WASH. POST (Oct. 26, 2021, 6:00 AM), https://www.washingtonpost.com/outlook/2021/10/26/wealth-tax-constitution-supreme-court/.

[145] U.S. CONST. art. I, § 2; Alan D. Viard, *Wealth Taxation: An Overview of the Issues*, ASPEN ECON. STRATEGY GRP. (NOV. 21, 2019), https://www.economicstrategygroup.org/wp-content/uploads/2019/12/Maintaining-the-Strength-of-American-Capialism-Wealth-Taxation-An-Overview-of-the-Issues.pdf.

[146] Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution*, 7 WM. & MARY BILL RTS. J. 1 (1998).

[147] *Id.*

Under the Sixteenth Amendment, income taxes are exempt from the apportionment requirement.[148] This allows income taxes to be applied on a federal level at a uniform rate instead of each state needing to determine its own appropriate rate. Challengers may claim that a mark-to-market tax is not an income tax for purposes of the Sixteenth Amendment (and is therefore a direct tax subject to the apportionment requirement) because it is not taxing realized income.[149] This realization requirement argument is founded upon the 1920 Supreme Court case *Eisner v. MacComber*, in which the Court held that stock dividends are not subject to income tax upon receipt because they have not yet been realized.[150] If this argument was correct, then the tax would most likely be impossible to administer based on the constraints imposed by the apportionment requirement.[151]

Since the Supreme Court's decision in *Eisner v. MacComber*, however, the Court has retracted its analysis in subsequent cases. For example, in the 1940 case *Helvering v. Horst*, the Court held that "the rule that income is not taxable until realized has never been taken to mean that the taxpayer . . . can escape taxation because he has not himself received payment of it from his obligor."[152] Under the Court's holding in *Helvering*, a mark-to-market tax on crypto gains would not be excluded from the Sixteenth Amendment solely because it taxes unrealized income. Most legal scholars today believe that realization is not a constitutional requirement for a sixteenth amendment eligible tax.[153] One could also look to the existence of I.R.C. § 475 and the previously mentioned expatriate tax as examples of currently enforced mark-to-market taxation in the United States that have yet to be repealed on constitutional grounds.

B. Funding Issues

Another popular argument against mark-to-market tax systems is that they are costly to enforce, and many of the costs would fall squarely on the shoulders of the Internal Revenue Service, an agency that has struggled to deal with shrinking budgets and workforce reductions over the past decade.[154] Critics may claim that the IRS would need to hire new agents while also training existing agents on potential new code sections addressing the mark-to-market system. With the IRS budget having been cut by $1.5 billion while

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[148] U.S. CONST. amend. XVI.

[149] Hemel, *supra* note 144.

[150] Paul Caron, *Miller: Bartlett, Realization, and the Constitution*, TAXPROF BLOG (Jan. 17, 2014), https://taxprof.typepad.com/taxprof_blog/2014/01/miller-.html.

[151] *See* Hemel, *supra* note 144.

[152] Helvering v. Horst, 311 U.S. 112, 116 (1940).

[153] Caron, *supra* note 150.

[154] *See* DEP'T TREASURY I.R.S, INTERNAL REVENUE SERVICE DATA BOOK OCTOBER 1,2020 TO SEPTEMBER 30, 2021*, 2021,* https://www.irs.gov/pub/irs-pdf/p55b.pdf.

also losing 17,000 agents between the years 2010 and 2019, the agency currently employs the same number of agents as it did in the 1950s.[155]

Although the costs associated with the implementation of any new revenue code provision will impose a burden upon the IRS, the costs relating to the cryptocurrency mark-to-market tax are not as taxing as many critics make them seem. Critics often claim that a tax which attempts to value unrealized assets presents a large administrative challenge. This is true for mark-to-market taxes that apply to all capital assets, since hard-to-value property such as derivatives and real estate become involved.[156] Cryptocurrencies have active markets, however. For example, an average of over 250,000 Bitcoin trades were placed each day in September 2021.[157] These active markets provide a price that is free to access and constantly updated.[158] Due to cryptocurrency being essentially free to appraise, the administrative costs associated with the crypto mark-to-market tax would be drastically lower than a general mark-to-market tax levied on items such as automobiles, machinery, and real estate.

VI. ALTERNATE METHODS OF REGULATION

A third counterpoint to introducing the mark-to-market tax on cryptocurrencies is that recent IRS publications have already addressed the issue. For example, in June of 2021, the IRS issued Memorandum Number: 202124008, which stated that cryptocurrencies were not eligible for like-kind exchanges under Revenue Code § 1031.[159] Under § 1031, a taxpayer may exchange similar property with another individual without having to recognize gains incurred during the swap.[160] In order to receive the tax-free status under § 1031, the exchanged properties need to be held either for productive use in a trade or business or for investment.[161] Crypto investors were previously able to exchange different types of cryptocurrencies without reporting any taxable gains under § 1031.[162] For example, an investor could exchange their bitcoin

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[155] Steven Toscher & Daniel Kellerman, *The Impact of "Big Data" on IRS Civil and Criminal Tax Enforcement*, L.A. Law. 14 (2019), https://www.taxlitigator.com/wp-content/uploads/2019/07/Big-Data-Article.pdf.

[156] Eastman et al., *supra* note 141.

[157] *Number of Daily Bitcoin Transactions Worldwide from January 2017 to September 13, 2021*, STATISTA (Sept. 14, 2021), https://www.statista.com/statistics/730806/daily-number-of-bitcoin-transactions/.

[158] *See Crypto Prices*, COINBASE, https://www.coinbase.com/price.

[159] Memorandum from Ronald J. Goldstein, Senior Technician Reviewer, Off. of Chief Counsel Internal Revenue Serv., to Michael Fiore, Area Counsel (June 8, 2021), https://www.irs.gov/pub/irs-wd/202124008.pdf.

[160] Eli Cole, *Cryptocurrency and the S 1031 Like Kind Exchange*, 10 HASTINGS SCI. & TECH. L.J. 75, 83 (2019).

[161] 26 I.R.C. § 1031 (a).

[162] Tom Geraghty, *IRS Concludes Section 1031 Tax-deferred "Like-kind" Exchange Treatment Is Not Available for Cryptocurrency Trades*, DLA PIPER, (July 19, 2021), https://www.dlapiper.com/en/us/insights/publications/2021/07/irs-concludes-section-1031-tax-deferred-like-kind-exchange-treatment/.

for stablecoins pegged to the U.S. dollar without having to recognize any gains. Since stablecoins always maintain a constant price, the investor could keep their earnings in the stablecoin with minimal risk.

One might argue that a tax overhaul like the mark-to-market system is overkill when the IRS can simply address issues using publications that don't require congressional approval such as notices, treasury regulations, revenue rulings, revenue procedures, and private letter rulings.[163] This patchwork method of addressing issues, however, will only create opportunities for new loopholes. For example, the IRS's 2017 attempt to regulate employee benefit plans with alternate guidance has led to a game of whack-a-mole in which new schemes are created to bypass the previously issued guidance.[164]

One might also argue that there are better ways to fight crime than with tax regulation. The SEC, for example, has developed an analysis for determining when cryptocurrencies should be classified as securities instead of property, as the IRS has chosen to classify them.[165] In 2018, this analysis was upheld by the Eastern District of New York in the case United States v. Zaslavskiy.[166] The court held that certain investment contracts involving cryptocurrency render the crypto a security and therefore the crypto automatically becomes subject to the Securities Act of 1933 and the Securities Act of 1934.[167] These acts allow the government to pursue prosecution for crimes involving cryptocurrency which would not be possible if the crypto remained classified as property.[168] This approach to fighting crime could be thought of as more efficient than having to pass new revenue code sections to address issues.

While this may be an effective way to prosecute crimes whenever a cryptocurrency transaction is able to fit into the "securities" classification, it is useless for any crypto-crime that does not involve securities regulations. Implementing a mark-to-market tax while also finding other ways to regulate cryptocurrency is much more effective and encompasses a fuller amount of the transactions involving crypto. Additionally, the mark-to-market tax would allow the IRS's newly created enforcement division to become involved which would have a large impact on investigating and prosecuting tax crime.[169] The

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[163] *See Understanding IRS Guidance - A Brief Primer*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer (last updated May 31,2022).

[164] Stephanie Cumings, *IRS Continues to Play Whack-a-Mole with Wellness Plans*, TAXNOTES (May 30, 2017), https://www.taxnotes.com/tax-notes-today-federal/benefits-and-pensions/irs-continues-play-whack-mole-wellness-plans/2017/05/30/18c5r.

[165] John Marinelli, *Meet the New Boss, Same as the Old Boss: How Federal Agencies Have Leveraged Existing Law to Regulate Cryptocurrency*, 57 AM. CRIM. L. REV. 34, 40 (2020).

[166] *Id.* at 41.

[167] *Id.* at 40.

[168] *Id.*

[169] *See* Steven Toscher, Sandra Brown, & Lacey Strachan, *IRS Cracks Down on Tax Fraud by Creating a New Enforcement Office*, 43 L.A. LAW. 10, 10 (2020).

Fraud Enforcement Office was established in 2020 to "further efforts by the IRS to detect and deter fraud," specifically in the areas of "fraudulent filings and related activities."[170]

VII. CONCLUSION AND RECOMMENDATION

Although each of these four criticisms raise what appear to be dooming challenges to the proposed crypto mark-to-market tax, none of them hold much water for the reasons stated above. The cumulative benefits of cryptocurrency mark-to-market taxation—limiting speculative investments by imposing an annual tax on unrealized gains,[171] curbing tax evasion through new reporting requirements,[172] and reducing market volatility by removing the incentives of wash sales—[173]outweighs the potential drawbacks of constitutional litigation, funding issues, and alternate methods of regulation. The one true hurdle that does stand in the way—Congress—will ultimately decide the fate of this consumer-protecting, crime-reducing, and revenue-producing regulation.

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[170] *Id.*

[171] *See supra* § IV(A).

[172] *See supra* § IV(C).

[173] *See supra* § IV(B).