Protecting blockchain from 'Mad Hatter' treatment

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When Alice, in Wonderland, ends up at the Mad Tea Party, she had this conversation:

Mad Hatter: 'Why is a raven like a writing-desk?'

...

'Have you guessed the riddle yet?' the Hatter said, turning to Alice again.

'No, I give it up,' Alice replied: 'What's the answer?'

'I haven't the slightest idea,' said the Hatter.

Well. The breakthrough distributed ledger technology known as the blockchain is being given the "Mad Hatter" treatment by the federal government.

The U.S. Commodity Futures Trading Commission (which to its credit has a very positive attitude toward the technology) is eyeing virtual currency as a commodity. The SEC is beginning to treat certain tokens, based on facts and circumstances, as a security. The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) has stated that certain activities involving convertible virtual currency constitute money transmission. The IRS treats convertible virtual currency as property.

Commodity? Security? Currency? Property?

Four different, inconsistent categories for the same thing.

In short: "I haven't the slightest idea."

Uncle Sam playing “Mad Hatter” bodes ominously for America’s center stage role in developing and implementing blockchain technology, one of the most important technological breakthroughs of our era.

What to do?

First things first. Tax policy drives human behavior (and business practices).
The Heritage Foundation recently proposed the optimal tax treatment of blockchain-based assets (as well as for gold and silver), suggesting that they be defined by the tax code as "alternative currency ... absent adopting a fundamental tax reform plan to ensure equal tax treatment among alternative currencies.

"One way to implement this method would be for Congress to (a) define capital asset ... to exclude “alternative currencies” from the definition of capital asset, and (b) exclude gains or losses from the sale or exchange of an alternative currency from gross income," the report added. Using this approach, alternative currency could be defined as "gold, silver … bullion or coin," "transferable certificate, electronic or otherwise, redeemable in gold, silver … bullion or coin," and "medium of exchange based on blockchain or similar technology."

The plan has also received enthusiastic support from Americans for Tax Reform and the Cato Institute. This is the approach that the Chamber of Digital Commerce, my trade association for the blockchain ecosystem, strongly endorses.

It is not merely a sensible approach. It is a crucial one.

There are terrible problems with taxing blockchain-based assets, like bitcoin, as an investment rather than as a competing currency. Among other things, it imposes massively onerous reporting requirements that have inhibited, and could defeat, the widespread adoption of this breakthrough technology for retail commerce.

Imagine if every time you bought a cup of coffee, with a fraction of a bitcoin (technically termed “satoshis”) that the differential between the market price of the bitcoin you used and your “cost basis” of the bitcoin when originally received had to be calculated, reported to the IRS, and a tax paid at the end of each year. Imagine how many transactions would have to be reported in normal retail commerce. It is, and would be, prohibitive.

The IRS has come under stinging criticism from the Treasury Inspector General for Tax Administration (TIGTA) in a detailed 2016 report for its current tax guidance on convertible virtual currencies. The IRS’s “John Doe Summons” for the records of half a million bitcoin owners has come under criticism from important Members of Congress such as Ways and Means Committee Chairman Kevin Brady and Senate Finance Committee Chairman Orin Hatch.
The IRS’s current approach is creating, to appropriate a phrase used in another context by former U.S. Senator John Warner, “a byzantine thicket full of potholes and quicksand.”

Remember what happened at the Mad Tea Party?

Alice got fed up with all the nonsense as it crossed over into insult and abuse.

And left.

"At any rate I'll never go there again!" Alice said as she picked her way through the wood. "It's the stupidest tea-party I ever was at in all my life!"

If the United States had such a convoluted regulatory climate when the internet, and the web, was first developing, what if the Moscow-born Sergei Brin, co-founder of Google, had persuaded his partner Larry Page to found Google in Moscow, rather than Silicon Valley?

What if the young Mark Zuckerberg (fluent in Mandarin and married to the American-born but ethnically Chinese Priscilla Chan) had decided to base Facebook in, say, Singapore, which is predominantly ethnically Chinese and which has an extremely welcoming regulatory climate? Those events would have represented a massive blow to the American economy and American technology leadership. Let's not court capital flight, brain drain, tens of thousands of jobs, billions of dollars of economic activity, fleeing America for a better Land of Opportunity. Let's have sensible federal policy keeping the leadership, jobs and innovation in this multi-trillion-dollar technological breakthrough right here in America. The best way to begin is by (a) defining a capital asset in the Internal Revenue Code to exclude "alternative currencies" — including but not limited to those blockchain-based from the definition of capital asset, and (b) excluding gains or losses from the sale or exchange of an alternative currency from gross income.

The way the federal government treats virtual currencies now is nonsensical. It's time for Uncle Sam to stop giving them the "Mad Hatter" treatment.