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TAX POLICY, PRACTICE & LEGISLATION COMMITTEE**

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**NEED FOR GUIDANCE FOR CALIFORNIA PURPOSES ON THE
APPLICATION OF IRC SECTION 1031 TO VIRTUAL CURRENCIES
AND OTHER DIGITAL ASSETS**

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EXECUTIVE SUMMARY

In 2008 a nine-page whitepaper, [“Bitcoin: A Peer-to-Peer Electronic Cash System”](#) was released under the pseudonym “Satoshi Nakamoto” to explain bitcoin and how it worked. In May 2010, two pizzas were purchased using 10,000 bitcoin.³ Today, CoinMarketCap lists over 4,000 types of virtual currencies, although most are not widely used or traded.

In 2014, IRS guidance stated that convertible virtual currency should be treated as property (rather than foreign currency). While that answered many income tax questions, more guidance is needed.

One open issue is what factors are relevant to know when one virtual currency is like kind to another for section 1031 purposes. Exchanges of virtual currencies are common because some may only be acquired by using another virtual currency. Also, because section 1031 is a mandatory provision, its application to virtual currency is important.

With the Tax Cuts and Jobs Act, the treatment of virtual currency under section 1031 for federal tax purposes became moot on a going forward basis because the provision now only applies to exchanges of real property. But California did not fully conform to this TCJA change. The pre-TCJA version of section 1031 continues to apply to the vast majority of individuals. The most likely personal asset held for investment or business that individuals exchange today is virtual currency.

This paper provides background on virtual currency and IRS guidance, the application of section 1031 particularly for intangible assets, and offers suggestions for factors to evaluate to determine when virtual currencies are like kind.

We highly encourage the FTB to provide guidance on the relevant factors to consider in determining if two virtual currencies meet the section 1031 like kind standard. This will be extremely helpful to taxpayers, particularly given that this rule is a mandatory one. We also suggest factors to consider for similar digital assets such as non-fungible tokens (NFTs). Finally, we recommend related guidance to help taxpayers, such as how to report virtual currency like kind exchanges on their California income tax return.

³ Kai Sedgwick, “Eight Historic Bitcoin Transactions,” Bitcoin.com, Nov. 26, 2018; <https://news.bitcoin.com/eight-historic-bitcoin-transactions/>.

DISCUSSION

I. INTRODUCTION

Virtual currency, often referred to as cryptocurrency,⁴ has become an active and growing element in numerous types of financial transactions, starting soon after bitcoin came into existence in 2009.⁵ Today, CoinMarketCap⁶ lists over 4,000 types of virtual currencies, although most are not widely used or traded.

Like fiat currency, several virtual currencies can be used to acquire goods and services. Some are convertible to U.S. dollar or other fiat currencies but not all. Virtual currencies are generally decentralized and that trait has led to creation of similar items often called “tokens” or digital assets. These assets are defined for purposes of this paper in Section II.

As new types of assets, virtual currency and other digital assets raise issues regarding the application of most federal and state laws including tax laws. The IRS first issued guidance on virtual currencies in March 2014 via subregulatory guidance—[Notice 2014-21](#). A key point in this guidance is that convertible virtual currency⁷ is treated as property for tax purposes rather than a foreign currency. Where specific guidance is lacking, the general tax rules governing property should be applied.⁸

Treatment of virtual currency as property means that whenever it is used to acquire goods, services or a different virtual currency or digital asset, an exchange occurs. Exchanges of property held for business or investment purposes requires

⁴ Some virtual currency may exist without the use of cryptography, although that likely means the currency is not decentralized. That is, a third party likely plays a role in the verification process to avoid the double-spend problem that bitcoin eliminated via use of the blockchain and cryptography. Letters that the IRS sent to over 10,000 holders of virtual currency referred to “transactions involving virtual currency, which include cryptocurrency and non-crypto virtual currencies” ([IR-2019-132](#) (7/26/19) and IRS Letters 6173, 6174 and 6174-A).

⁵ See the Bitcoin whitepaper released in 2009, “Bitcoin: A Peer-to-Peer Electronic Cash System,” by Satoshi Nakamoto (a pseudonym); <https://bitcoin.org/en/bitcoin-paper> and <https://bitcoin.org/en/faq#general> (noting the 2009 publication of the whitepaper).

⁶ CoinMarketCap is a “price-tracking website for crypto assets” including for over 6,000 cryptocurrencies, and provides data on over 250 virtual currency exchanges and over 300 non-fungible tokens; <https://coinmarketcap.com/>.

⁷ Notice 2014-21 uses the term “convertible virtual currency” to mean a “virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency;” <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

⁸ Per Q&A-1 of Notice 2014-21, “general tax principles applicable to property transactions apply to transactions using virtual currency;” <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

consideration of section 1031 on like-kind exchanges, which if applicable, is a mandatory provision.

The Tax Cuts and Jobs Act of 2017 (P.L. 115-97; 12/22/17) changed IRC section 1031 on like-kind exchanges to only apply to real property for exchanges completed after December 31, 2017. Thus, for virtual currency held for investment or business purposes, the like-kind exchange rule does not apply for exchanges after 2017, and it is unlikely the IRS will issue formal, binding guidance on such transactions.⁹

California did not fully conform to the TCJA change to section 1031. In California, the pre-TCJA version of section 1031 continues to apply to individuals filing as head of household, surviving spouse, or married filing jointly with adjusted gross income less than \$500,000 and taxpayers filing as single with adjusted gross income less than \$250,000 for the tax year in which the exchange begins. Thus, the question of how section 1031 applies to virtual currency and other digital assets continues to be an issue in need of guidance in California.

We encourage the Franchise Tax Board (FTB) to issue such guidance as it will be a tremendous benefit to owners of virtual currency and other digital assets as proper understanding and application of section 1031 is important given that it is a mandatory provision.

This paper provides background on virtual currency, some other digital assets, and section 1031 as applied to intangible assets and offers suggestions for the guidance we encourage the FTB to issue.

II. DEFINING VIRTUAL CURRENCY AND OTHER DIGITAL ASSETS

A. Tax Definition

For tax purposes there are four main definitions of what constitutes virtual currency. The root definition of virtual currency that all other tax definitions flow from is a 2013 FinCen definition that states “In contrast to real currency, “virtual” currency is a medium of exchange that operates like a currency in some

⁹ In June 2021, the IRS issued Chief Counsel Advice (CCA) 202124008 addressing the application of section 1031 to three specific types of virtual currency. This CCA is discussed in this paper; it is not binding guidance for the IRS or taxpayers.

environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction.”¹⁰ Other similar but slightly different definitions are found in Notice 2014-21 and Revenue Ruling 2019-24.

The current IRS definition is found in the IRS’s virtual currency FAQs Q1: What is a Virtual Currency?

The IRS defines the answer to what is a virtual currency as: “Virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency (“real currency”), that functions as a unit of account, a store of value, and a medium of exchange. Some virtual currencies are convertible, which means that they have an equivalent value in real currency or act as a substitute for real currency. The IRS uses the term “virtual currency” in these FAQs to describe the various types of convertible virtual currency that are used as a medium of exchange, such as digital currency and cryptocurrency. Regardless of the label applied, if a particular asset has the characteristics of virtual currency, it will be treated as virtual currency for Federal income tax purposes.”

B. Technical Attributes

The legal definition of a virtual currency is far different from a technical explanation of how virtual currencies work. To function as a digital representation unit of account or store of value, virtual currencies are most commonly recorded and transferred on a distributed ledger or blockchain. The use of a blockchain allows for a particular community of users to agree upon ownership of particular units of the blockchain associated with public keys and to transfer ownership from one agreed upon owner to the next. In many ways this blockchain can be thought of as a digital land registry where one agreed upon owner can transfer their interest in an address to a new owner if the collective body of users can trace the transferor’s ownership back to the original creation of the address.

Just as each county has its own set of rules on how deeds are to be formalized and perfected, so does each blockchain. Some, like bitcoin, have limitations on the number of coins and block size that incentivize users to prioritize

¹⁰ FinCen FIN-2013-G001. Note: In September 2021, El Salvador gave bitcoin legal tender status. Reasons for this elevation include to aid transfers of funds from people outside of the country to residents, assist residents who lack access to financial accounts, and promote investment. Joe Hernandez, “El Salvador Just Became The First Country to Accept Bitcoin As Legal Tender,” NPR, Sept. 7, 2021; <https://www.npr.org/2021/09/07/1034838909/bitcoin-el-salvador-legal-tender-official-currency-cryptocurrency>.

coins as a store of value. Others, such as Ethereum can run smart contracts that let users build on top of the verified ownership and secure transfer protocols. Still others, such as Solana, can support tens of thousands of transactions per minute and promote the Solana blockchain as an ideal method to make payments.

Each of these blockchains and systems that enable them to function have much in common. They are vast communication hubs where thousands of computers can work together to verify ownership and transfers. They have a precise order of transactions where space on the blockchain has established owners, and they have an incentive structure that allows the transfers to be completed in a decentralized environment. Finally, the ownership is fundamentally the same. Each virtual currency owner has possession over a unit of storage on this distributed ledger.

Despite the IRS's pronouncement that virtual currencies are property most of the units of storage are fungible. A newly created bitcoin in 2010 is substantively identical to a bitcoin created in 2021. This technological fungibility allows virtual currencies to be traded on exchanges at more or less the same price in U.S. dollars.

Recently a new type of token has been built on top of several blockchains.¹¹ Like the fungible tokens, Non-Fungible Tokens or NFTs are part of the blockchain and share many of the same attributes such as the fungible token. However, as the name implies, there is only one NFT per address. Whoever owns that specific address also owns the NFT and any rights associated with the NFT. The NFT may represent various assets including artwork, trading cards, name or image of someone, and various rights including copyright.

III. BASICS OF IRC SECTION 1031 – BEFORE AND AFTER THE TAX CUTS AND JOBS ACT AND AFTER THE CALIFORNIA CHANGE (AB 91 (2019))

A. Section 1031 Basics

¹¹ In lay technology terms certain blockchains allow developers to write programs that are executed using the blockchain protocol similarly to developers writing apps on Apple's iOS.

Section 1031(a)(1) of the Internal Revenue Code of 1986, as amended (the “Code”) provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment if that real property is exchanged solely for real property of like kind which is to be held either for productive use in a trade or business or for investment. Section 1031 is a mandatory provision, not an elective one. To avoid the deferral treatment, taxpayers must structure a property transaction to fall outside of section 1031, such as by selling the property rather than exchanging it.

Generally, if a transaction qualifies for section 1031 treatment, any realized gain (but not loss) will be recognized to the extent of the sum of the money (including liabilities assumed) received and the fair market value of nonqualifying property received.¹² Qualifying property for 1031 purposes is property of a like kind held for productive use in a trade or business or for investment, but not property held primarily for sale.¹³ Section 1031 is intended to apply to transactions where the taxpayer's economic situation following the exchange is essentially the same as it had been before the transaction.¹⁴ Thus, both the relinquished property and the replacement property must be held for either productive use in a trade or business, or investment.

Prior to the TCJA, section 1031(a)(2) excluded the exchange of the following types of property (which continue to be ineligible property under the California like-kind exchange rules (explained later)):

- (i) Stock in trade or other property held primarily for sale;
- (ii) Stocks, bonds, or notes;
- (iii) Other securities or evidences of indebtedness or interest;
- (iv) Interests in a partnership;
- (v) Certificates of trust or beneficial interests; or
- (vi) Choses in action.

B. Basics of “Like Kind”

¹² IRC §1031(b).

¹³ IRC 1031(a)(1) and (2).

¹⁴ H. Rept. 704, 73d Cong., 2d Sess. (1934), 1939-1 C.B. (Part 2) 554, 564.

Treas. Reg. § 1.1031(a)-1(b) defines "like kind" to mean the nature or character of the property and not the grade or quality. One kind or class of property may not be exchanged for property of a different kind or class. For example, an investor who exchanged gold bullion for silver bullion was required to recognize gain in part because silver is primarily used as an industrial commodity while gold is primarily used as an investment.¹⁵ Similarly, an investor who exchanged one kind of gold coin for another kind of gold coin was required to recognize a gain because one coin's value was derived from its collectability while the other's value was derived from its metal content.¹⁶

Treas. Reg. § 1.1031(a)-2(a) further explains like kind and class as follows with respect to personal property:

Section 1.1031(a)-1(b) provides that the nonrecognition rules of section 1031 do not apply to an exchange of one kind or class of property for property of a different kind or class. This section contains additional rules for determining whether personal property has been exchanged for property of a like kind or like class. Personal properties of a like class are considered to be of a "like kind" for purposes of section 1031. In addition, an exchange of properties of a like kind may qualify under section 1031 regardless of whether the properties are also of a like class. In determining whether exchanged properties are of a like kind, no inference is to be drawn from the fact that the properties are not of a like class. Under paragraph (b) of this section, depreciable tangible personal properties are of a like class if they are either within the same General Asset Class (as defined in paragraph (b)(2) of this section) or within the same Product Class (as defined in paragraph (b)(3) of this section). Paragraph (c) of this section provides rules for exchanges of intangible personal property and nondepreciable personal property.

Treasury regulations provide additional explanation as well as restrictions on the term "like kind." For example, Treas. Reg. 1.1031(a)-2(c)(2) provides that goodwill or going concern value of a business is not like kind to goodwill or going concern value of another business. Treas. Reg. 1.1031(a)-2(b) specifies that for depreciable tangible property to be like kind to other depreciable tangible property, generally it must be in the same General Asset Class or Product Class.

¹⁵ Rev. Rul. 82-166; discussed further later.

¹⁶ Rev. Rul. 79-143; discussed further later.

Generally, the definition of like kind for real property is broader than for personal property. For example, improved real property can be like kind to unimproved real property as the term “relates only to the grade or quality of the property and not to its kind or class.”¹⁷ In contrast, a truck is not like kind to a car because they are in different Asset Classes for depreciation purposes.¹⁸ Also, a copyright on a novel is not like kind to a copyright on a song, but would be like kind to a copyright on a different novel.¹⁹ Further details and examples of the application of section 1031 to intangibles is covered in Section IV.

C. California’s Version of Section 1031

Section 24941 of the California Revenue and Taxation Code (“R&T”) conforms to Federal section 1031, with a significant exception after the Federal Tax Cuts and Jobs Act of 2017 (“TCJA”) (Public Law 115-97, Dec. 22, 2017).²⁰

Starting with tax year 2018, the TCJA limited section 1031 like kind exchanges to real property. Prior to the TCJA change, section 1031 could apply to exchanges of personal property (both tangible and intangible) held for business or investment.

California AB-91, “Loophole Closure and Small Business and Working Families Tax Relief Act of 2019,” conformed to this change for transactions occurring after January 10, 2019²¹ except for individuals filing as head of household, surviving spouse or married filing jointly with adjusted gross income less than \$500,000 and taxpayers filing individually (single) with adjusted gross income less than \$250,000 for the tax year in which the exchange begins. For those taxpayers, the pre-TCJA rules of section 1031 apply.²²

¹⁷ Treas. Reg. 1.1031(a)-1(b).

¹⁸ Treas. Reg. 1.1031(a)-2(b)(2) where a light truck is in asset class 00.241 and a car is in asset class 00.22.

¹⁹ Treas. Reg. 1.1031(a)-2(c) and Examples 1 and 2 at Treas. Reg. 1.1031(a)-2(c)(3).

²⁰ R&T section 24941 provides as follows: “Section 1031 of the Internal Revenue Code, relating to exchange of property held for productive use or investment, shall apply, except as otherwise provided.”

²¹ R&T section 24941.5 provides:

(a) The amendments made by Section 13303(a) and (b) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 1031 of the Internal Revenue Code, relating to Exchange of real property held for productive use or investment, shall apply, subject to subdivision (b).

(b) (1) This section shall apply to exchanges completed after January 10, 2019.

(2) This section shall not apply to an exchange where the property to be disposed of by the taxpayer in the exchange is disposed of by that taxpayer on or before January 10, 2019, or where the property to be received by the taxpayer in the exchange is received by that taxpayer on or before January 10, 2019.

²² R&T section 18031.5.

IV. BASICS OF SECTION 1031 AS APPLICABLE TO INTANGIBLE ASSETS SUCH AS VIRTUAL CURRENCY

A. Cryptocurrency Is Intangible Property

In Notice 2014-21, the IRS concluded that virtual currency is treated as property for federal income tax purposes, not as currency. As intangible property not excluded by statute, virtual currency held for business or investment purposes, would be subject to section 1031 under federal law if exchanged for like kind property before 2018. California law conforms to Federal Code section 1031 only for individuals who are below the adjusted gross income thresholds contained in AB-91. Because most individuals in California do not have income above these thresholds, virtual currency may be subject to section 1031 for California state tax purposes for most Californians.

The issue that exists is to know what factors are relevant to know if one virtual currency is like kind to another virtual currency. To address this, the Treasury regulations on the application of section 1031 to intangible assets are explained along with various IRS rulings on similar type of assets as well as a 2021 Chief Counsel Advice (CCA) where the IRS addressed the like kind question for three out of over 5,000 types of virtual currency.

B. IRS Guidance on Section 1031 and Intangible Property

Treas. Reg. 1.1.1031(a)-2(c)(1) on exchanges of intangible property provides the following general rule.

An exchange of intangible personal property or nondepreciable personal property qualifies for nonrecognition of gain or loss under section 1031 only if the exchanged properties are of a like kind. No like classes are provided for these properties. Whether intangible personal property is of a like kind to other intangible personal property generally depends on the nature or character of the rights involved (e.g., patent or a copyright) and also on the nature or character of the underlying property to which the intangible personal property relates.

Based on this regulation, the meaning of the “underlying property to which the intangible personal property relates” is important. This is not explained in the regulations other than by examples where a copyright on a book is not like kind to

a copyright on a song. These examples do not explain why assets protected under the same law and providing similar rights are not like kind.

IRS Technical Advice Memorandum (TAM) [200035005](#) (Sept. 1, 2000) involved the exchange of “Federal Communications Commission (FCC) radio broadcast station licenses (radio licenses) for an FCC television broadcast station license (television license).” It expands on the explanation in Reg. 1.1031(a)-2(c) on like kind and the “underlying property”. Thus, this analysis should be useful to help determine when digital assets are like kind. The IRS found the licenses to be like kind.

Relevant facts about transmitting licenses include (per the TAM): “both radio and television are transmitted over the electromagnetic spectrum by radio transmitting equipment. The Communications Act further grants the FCC the power to “assign frequencies for each individual station and determine the power which each station shall use and the time during which it may operate.”” Because television involves more data, a larger bandwidth is needed for it compared to what a radio broadcasting station needs.

Similarities in the radio and television licenses included that each conferred “a right to use the radio transmitting apparatus to broadcast on a designated channel and frequency range, at designated hours of operation, at designated geographic locations, at a maximum effective radiated power, and using antenna with certain antenna system specifications.” Also, each represented a license from the U.S. rather than ownership. A license provides “rights to use radio transmitting apparatus to broadcast programming (whether radio or television) over a portion of the electromagnetic spectrum at a certain power in a designated geographic area.”

As to exchanges of intangible personal property, the IRS stated: “Whether intangible personal property is of a like kind to other intangible personal property generally depends on the nature or character of the rights involved (e.g., a patent or a copyright) and also on the nature or character of the underlying property to which the intangible personal property relates. For example, an exchange of a copyright on a novel for a copyright on a different novel is a like kind exchange, but an exchange of a copyright on a novel for a copyright on a song is not a like kind exchange.” It then analyzed the FCC licenses under these two requirements: (1) nature or character of the rights involved, and (2) the nature or character of the underlying property to which the intangible personal property relates.

(1) *Nature or Character of the Rights Involved*: The IRS stated that it should look at the “substance of the specific rights granted in the FCC licenses, and not merely the labels”. In doing so, the IRS found mostly similarities.

Similarities	Differences
Rights granted by federal government for benefit of the general public.	Specific terms and conditions of operation likely vary.
License enables licensee to broadcast programming to public free of charge over the electromagnetic spectrum for the duration of the license.	Label (radio versus television).
Rights conferred to licensee and specifically enumerated in the FCC license.	Specific operating parameters (such as frequency, operating hours, power, and antenna information) and geographic location. (Described by the IRS as mere differences in grade or quality, which do not change the nature or character of the rights that are granted.)
License confers a right to use referenced radio transmitting apparatus to broadcast on a designated channel and frequency range, at designated hours of operation, at designated geographic locations, at a maximum effective radiated power, and using antenna with certain antenna system specifications.	

(2) *Nature or Character of the Underlying Property*: The IRS stated that the underlying assets must be analyzed to determine if the intangible assets are like kind. The parties disagreed as to what the underlying property was (for example, the equipment needed to make the license useful or the various intangibles associated with broadcasting such as market potential). The IRS concluded that

“the license principally relates to the use of the radio transmitting apparatus, rather than [the] apparatus itself.” The license did not give any rights to own or use transmitting apparatus. It instead represented the FCC’s “decision to assign a specific frequency of the electromagnetic spectrum to a particular licensee in a given broadcast area. Thus, the “assigned frequency of the electromagnetic spectrum noted in the license” is the underlying property.

In the TAM, the IRS references some rulings involving gold used for numismatic (collectible) purposes versus bullion (metal) purposes (see table below). Per the IRS, these rulings “indicate that functional differences between seemingly similar properties can be relevant in determining whether two properties are like kind.”

The differences in the underlying property noted by the IRS were found to be only of grade or quality rather than in nature or character. These differences in grade or quality are:

- The frequency bands of the usable radio frequency spectrum (larger for television than for radio).
- Licensees may not use radio frequency to broadcast radio transmissions or vice versa.

Importantly, the IRS stated that like kind does not require assets to be identical or completely interchangeable. The IRS concluded that the FCC radio license and FCC television license were like kind under section 1031.

Section 1031 Rulings Involving Coins and Bullion²³

Ruling	Item 1	Item 2	Like kind?	Rationale
Rev. Rul. 76-214	Mexican 50-peso gold coins	Austrian 100-corona gold coins	Yes	Both coins are bullion-type, with value measured by their gold content. Neither is considered currency in the issuing country. When they are not circulating currencies, the differences “are primarily of size, shape, and amount of gold

²³ Most of this table is from Annette Nellen, “Bitcoin taxation: Clarity and mystery, *AICPA Tax Insider*, June 12, 2014; https://web.archive.org/web/20160105103830/http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2014/Tax/BitcoinTaxation.jsp.

				content.” Thus, the nature or character of the coins is the same.
Rev. Rul. 79-143 (also see GCM 37811 (1/5/79))	\$20 gold numismatic -type coins	South African Krugerrand bullion-type gold coins	No	Although both items are gold, the underlying investments are different (bullion-type coins versus numismatic-type coins). In the GCM, the IRS states that the numismatic coins may be valued for their condition, age or beauty, in addition to their gold content. In contrast, bullion coins are valued based on the price of gold.
Rev. Rul. 82-96	Gold bullion	Canadian Maple Leaf gold coins	Yes	While the Canadian coin was legal tender in Canada to its face value of \$50, it was not being used that way because the gold value was greater than \$50. Thus, both coins were viewed as bullion-type coins with similar nature and character.
Rev. Rul. 82-166 (also see GCM 38899 (9/27/82))	Gold bullion held for investment	Silver bullion held for investment	No	Gold and silver are different metals, used in different ways (gold for investment; silver as an industrial commodity). In the GCM, the IRS stated that a taxpayer who exchanges gold bullion for silver bullion “is not in essentially the same economic situation after the exchange as he or she was in before the exchange.” The IRS also noted that gold and silver as commodities were subject to different market forces.
<i>California Federal Life Insurance Company</i> , 76 TC 107 (1981), aff’d 680 F2d 85 (9 th Cir. 1982)	Swiss francs	U.S. Double Eagle gold coins	No	The gold coins are of numismatic value, “valued primarily for their rarity, as collector items.” Swiss francs represent a circulating currency. Thus, the items are not of the same nature or character.

C. Chief Counsel Advice of 2021 Applies Section 1031 to Three Types of Cryptocurrency

The IRS recently released a CCA 202124008 (June 18, 2021) concluding that, for pre-TCJA transactions, an exchange of (1) Bitcoin for Ether, (2) Bitcoin for Litecoin, or (3) Ether for Litecoin does not qualify as a like-kind exchange under section 1031. The CCA expressly does not apply to other types of cryptocurrency.

In the CCA, the Office of Chief Counsel reasoned that Bitcoin and Ether held a unique position within the cryptocurrency market because an individual seeking to invest in a cryptocurrency other than Bitcoin or Ether would generally need to first buy Bitcoin or Ether and exchange that Bitcoin or Ether for another cryptocurrency. Because of this difference, Chief Counsel concluded that Bitcoin and Ether each differed in both nature and character from other crypto, such as Litecoin, and did not qualify as like kind property for purposes of section 1031. The Chief Counsel also concluded that Bitcoin and Ether were not like kind because of the differences in overall design, intended use, and actual use because Bitcoin is designed to act as a unit of payment while Ether acts as a payment network and as a platform for operating smart contracts and other applications.

A CCA is not a non-binding court ruling, statute, or regulation but is instead a policy or position statement of Chief Counsel's office.²⁴ No other ruling or regulation has addressed the issue.

V. SUGGESTIONS FOR GUIDANCE TO DETERMINE WHEN DIGITAL ASSETS ARE LIKE KIND

A. Recommended Like Kind Factors for Virtual Currency

In identifying relevant factors to determine if two virtual currencies are like kind, important points to bear in mind from the Code, regulations, and rulings include:

²⁴ Definition of Chief Counsel Advice, IRM § 33.1.3.1.1.

- Like kind refers to the nature or character of the property and not its grade or quality. [Treas. Reg. § 1.1031(a)-1(b)]
- “Whether intangible personal property is of a like kind to other intangible personal property generally depends on the nature or character of the rights involved (e.g., patent or a copyright) and also on the nature or character of the underlying property to which the intangible personal property relates.” [Treas. Reg. 1.1.1031(a)-2(c)(1)]
- “Even the narrowest interpretation of the like kind standard does not require that one property be identical to another or that they be completely interchangeable” [TAM 200035005, summarized earlier]

It is also important that the currency not be an asset excepted from section 1031 treatment such as dealer property or a security.

Based on our analysis of virtual currency, we suggest the following factors be considered to determine if such assets are like kind for section 1031 purposes.

Feature of the virtual currencies	Indicates Like Kind	Comments
Property for tax purposes	X	Cannot be a fiat currency. Meets the definition of convertible virtual currency as used in Notice 2014-21 and Rev. Rul. 2019-24.
Permissionless distributed ledger used to record transactions	X	The blockchain technology used to verify transactions is similar enough among virtual currencies. If the blockchain is permissioned, the requirements of the party that controls the ledger are likely to be different from other permissioned and permissionless ledgers to not be like kind.
Permissioned distributed ledger used to record transactions		
Underlying asset used for commerce or a store of value	X	If both used for commerce or store of value, they should be like kind. This would include Litecoin for Bitcoin (despite the conclusion in CCA 202124008).

(similar to fiat currency).		
Convertible to a fiat currency.	X	Some virtual currencies are not convertible into a fiat currency. They must be obtained using another virtual currency, such as bitcoin.
Used to enable smart contracts.	X	If one currency can be used for smart contracts but not another, there is a difference in the nature or character of the properties.

B. Recommended Like Kind Factors for NFTs

In identifying factors that could inform if section 1031 should apply for NFT purposes there are several points to consider. The first factor that should be considered is if the NFT and the other asset for like kind exchange purposes are on the same blockchain. From a technical standpoint, an NFT of artwork and the Ethereum used to purchase the NFT have many similar attributes. They are both addresses on the same blockchain. They use the same computers to verify the transaction, and they have the same risk of loss. They are simply different data points on the same ledger. An exchange of an NFT for another NFT on the same blockchain would be a strong indicator of like kind assets.

A second layer of NFT analysis for section 1031 purposes is the aesthetics or collectable nature of the NFT. NFTs of art for example share many of the same attributes as other art NFTs since NFTs are digital assets. The same goes for digital trading cards. This type of analysis would permit a side-by-side comparison of the assets to see how similar they are to the user.

Based on our analysis of NFTs, we suggest the following factors be considered to determine if such assets are like kind for section 1031 purposes.

Factor	Indicates Like Kind	Comments
Property for tax purposes	X	Cannot be a fiat currency.
Represents ownership of a similar right such as to display the image	X	Shares many of the same attributes as the fungible tokens that share the same blockchain. Does the NFT represent a similar class of asset? Is it art for art or trading card for trading card? Are there similar rights (or lack thereof) such as copyright associated with the NFT.

associated with the NFT.		
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C. Related Section 1031 Guidance Needed

Under California law, virtual currency that is like kind to other virtual currencies continues to fall under the mandatory gain and loss deferral of section 1031 for most individuals given the high adjusted gross income thresholds for like kind exchange treatment after enactment of AB-91 in 2019.

This area of California-federal nonconformity necessitates guidance on how section 1031 exchanges should be reported for California purposes when the transaction is not eligible for like kind exchange treatment for federal tax purposes (including whether a Form 8824 should be included with the California return). In addition, if particular records are needed for California purposes that would not be kept for federal purposes (because section 1031 doesn't apply to the asset), we encourage the FTB to specify what these records are or what taxpayers must be able to substantiate.

Given digital asset transactions have been in existence for over ten years, guidance on the application of section 1031 should be prospective at the election of the taxpayer. That is, given the uncertainty that existed in this area, reasonable positions taken on prior returns should generally be respected. Indicators of reasonableness include reliance on an adviser who researched the matter.