Virtual Currencies, IRS, Treasury & Federal Reserve

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“I want to change the paradigm”

Joseph R. Biden, 3/25/2021

Virtual Currencies, IRS, Treasury & the FED

The Coronavirus has wreaked havoc with the U.S. economy and most other economies around the world. Governments everywhere are scrambling to mitigate the damage. An earlier effort in the U.S. was President Biden's $1.9 trillion American Rescue Plan (ARP), which many see as just a down payment on the total financial relief that will be needed to get the American economy fully back on its feet.

But the reality is, we the people are in a position to substantially help our own local economies, by reaching for a solution that we have used to great effect in the past, in circumstances very like these. What we did then, and can do today, is to issue local complementary currencies.

The benefits of this kind of "people's money" can be dramatically enhanced if Congress were to include this idea as a small rider in any bill.

Background

The most critical thing needed by the vast majority of Americans, both businesses and individuals, is more money – in substantial and ongoing amounts. The common wisdom is that money needed can only come through Congress. The ARP passed because of the budget reconciliation process. However, unless the reconciliation process can be used again, future allocations are less likely given current circumstances unless the filibuster is eliminated.

Fortunately, there is another way in which society can get the money it needs, and it doesn't require any action by Congress – but that solution can be dramatically enhanced with just a little help from lawmakers.

Here is how.

We the people, can issue our own money and use it to address our own needs. Sound crazy? It's not, and in fact, it has been done many times. The Federal Reserve has called such money "Private Money" as described in this 2008 article published by the Cleveland FED titled *Private Money in our Past, Present, and Future*.[1] That article states:

> ***"The government isn't the only entity allowed to issue money. Private citizens and businesses can too, and throughout U.S. history, they often have."***

Private money goes by various names such as virtual currencies,[2] complementary currencies, local or community currencies,[3] digital currencies and alternative currencies. It includes Buy Local campaigns, and programs like air mileage/awards credit cards and grocery store points/rewards. (Cryptocurrencies are different in that they are speculative and not used primarily to conduct transactions in the regular economy.)

Complementary currencies are actually the standard worldwide, more historical than fiat currency (government issued, no underlying value). While used even in the U.S. today (e.g., Berkshares), they are most impactful in times of crisis to rescue and bolster economies by providing access and liquidity when fiat markets are volatile and restrictive.

The topic of money, what it really is and what alternatives are available are explored in this three-part article titled *Money – It's Not What Most of Us Think*.[4] In particular it explores how non-government players can issue their own currencies to address needs not satisfied by national currencies.

We recommend that the issuer be a non-profit or a group of non-profits so that the issuer's public service mandate is clear and the benefits flow to all and not just a few.

What is Private Money? What Can be Done With It?

Most people have already used an alternative currency without realizing it. Every time someone clips a coupon they are actually using a complementary currency. In fact, the world's most pervasive complementary currency goes by the much more familiar name of frequent flyer programs.[5]

Part of the problem is that most people have unconscious biases that money can only be a national currency like the U.S. dollar. Yet throughout history there have been, and are, thousands of complementary currencies. We highlight a few examples in this article *Complementary Currencies in Use*.[6] This one-page document[7] gives a sense of what is possible with these local currencies.

One particularly effective solution in the pandemic-caused financial crisis is the use of a complementary currency to hire people as employees or contractors. Another would be to use the currency to buy troubled assets from banks, including defaulting mortgages and seized properties. These topics are explored further in the two sections below concerning the IRS, Treasury, the FED and banks.

And there is good news on complementary currencies. Due to the pandemic, local currencies are proliferating worldwide, as documented in this Bloomberg article, *Short on Money, Cities Around the World Try Making Their Own*,[8] and this article *How Tenino's wooden money is reviving the idea of local currencies*.[9]

How Current Tax Policy Inhibits Local Currencies

Done right, a local currency can substantially bootstrap a local economy, allowing the people to lift themselves up rather than depending on external entities like the federal government. However, successfully launching a local currency entails getting a sufficiently large group of individuals and businesses to accept the currency as "real money" and therefore viable for paying wages and conducting commerce. Unfortunately, current federal tax policy inhibits achievement of this critical mass.

How? As soon as two or more parties exchange goods or services for something all parties call their own money (currency), the IRS considers such transactions taxable (as if they were done with US dollars instead of the private money) if they exceed the thresholds that trigger taxability.

The problem is, the IRS requires the tax to be paid in dollars rather than in the currency used. The nuances of this are covered in this bulletin published by the IRS - Notice 2014-21.[10]

The net effect is that many local economic development programs based on the issuance of a local currency will die before they get off the ground.

How exactly does this happen?

Let's say that a community economic development organization wants to launch a local work program to hire youth, unemployed and others to do work similar to that done under the Civilian Conservation Corps[11] during the FDR administration. The organization could issue a local currency to pay those employees.

However, currently the employees and the organization would have to pay taxes on those salaries in dollars. Lacking the matching dollars for the required employment taxes, the program would be killed before it gets started.

However, if those taxes could be paid with the local currency, the program could launch and grow to match the need without constraint. Better yet, if all transactions in those non-profit-issued currencies were to be made exempt from federal taxation, many such programs would be facilitated. The latter is much easier to enable.

Change Tax Policy to Not Tax Local Currencies

The quickest and easiest thing that the government can do to aid the deployment of local currency-driven economic development programs is to change tax policy to exempt community currencies from taxation. We recommend that those currencies be limited to those issued for regional economic development purposes by non-profit organizations registered under IRS section 501(c)(3) or 501(c)(4), rather than by for-profit organization or any other non-profit organization formed under 501(c). That way the program would inure to the benefit of the public at large and not individuals.

Further, we would recommend that all manner of transactions done using those local currencies be considered non-taxable, whether for goods or services. Should the federal government determine at a later date that such transactions should be taxed, then the taxes due should be able to be paid in that local currency rather than with USD, as is current policy.

So, What Can the Federal Government do to Help?

There are two simple and non-controversial things that Congress can do to facilitate the use and impact of complementary currencies nationwide.

- Get the IRS to exempt complementary currencies from federal taxes triggered by transactions in those currencies, if those currencies are issued by a 501(c)(3) or 501(c)(4) non-profit organization for regional economic development purposes.
- Get the Federal Reserve to purchase those currencies from banks that wish to sell them in exchange for dollars.

Both of these are eminently doable. Let's look at each one in detail.

1

Get the IRS to Exempt Community Currencies

The easiest way to get the IRS to exempt certain alternative currencies from payment of taxes is to modify IRS Code Title 26, Subtitle A, Chapter 1, Subchapter F, Part 1, Section 501 to include a new subchapter (s) to provide for that exemption. Here is the suggested language:

> "All financial transactions made with a community virtual currency issued for purposes of localized economic development by entities formed under § 501(c)(3) and § 501(c)(4), shall be exempt from federal taxation."

Such language could be inserted as a rider in almost any bill related to economic issues. It also might be possible for the Secretary of the Treasury to issue an executive directive with the same effect since the Secretary has a good deal of authority and flexibility under 26 U.S. Code Title 26—Internal Revenue Code[12] to establish rules and procedures with respect to taxation issues.

What would be the immediate impact of the IRS not taxing virtual currencies used for local economic development?

Work Programs

As indicated above, one of the immediate and key impacts of getting the IRS to take this step is to open up the prospects of launching a number of jobs programs, thereby addressing one of the key economic problems exacerbated by the pandemic. To understand how significant that is, we first need to understand the current circumstance and how it would change with this small but hugely significant step on the part of the IRS.

Current

Currently, if an organization wants to hire someone to perform work for them (as an employee or a contractor), and pay them in a complementary currency, the IRS would require both the employer and employee (or contractor) to pay any taxes due in US dollars. (See aforementioned IRS Notice 2014-21.) Most such organizations have plenty of the complementary currency but almost none of the dollars that would be needed.

Proposed

That situation totally changes if the IRS would consider the relevant complementary currency exempt for payment of taxes due on transactions in that currency. Both the worker and employer in our example would not have to pay any taxes on transactions in the applicable currency. The result would be nearly incalculable in that a shortage of dollars would not impede work programs, thereby providing critical wages needed to keep local economies alive.

2 Job Losses, Foreclosures & Troubled Bank Assets

Another area that could be impacted dramatically by this policy change concerns the use of a complementary currency to address several other growing problems. The pandemic has devastated local economies, directly impacting the millions of small and mid-sized companies that account for around half of all U.S. economic activity. The result is unemployment that is nearing and may well exceed that experienced during the Great Depression.[13]

An inevitable consequence of an avalanche of laid off workers is that a very high percentage will be unable to pay their bills. Many will face foreclosure, car repossessions, credit card limits, late fees and penalties, damaged credit ratings and much more.

A growing number of homeowners are defaulting on their mortgages[14] and that number will likely be much worse[15] than the wave of foreclosures the followed the financial crisis of 2008-2012. Foreclosures in particular represent a major problem that impacts many more parties than do other credit issues.

Foreclosures have a compounding negative effect on local communities,[16] including:

- *Evicted homeowners potentially exacerbating already high homeless numbers.[17]*
- *Dropping property values.[18]*
- *Decreases in tax revenue to local governments prior to foreclosure.*
- *Increases in OREO property[19] held by banks and credit unions that are bad for their liquidity.[20]*

Stopping foreclosures can dramatically improve those circumstances for all concerned. A complementary currency is an ideal tool in this situation. It could be used to purchase troubled assets from banks and other lenders, including mortgages and their notes pre-foreclosure and property already seized post foreclosure.

Once those loans and other debt instruments are acquired, borrowers could be granted payment forbearance or reduction until back on their feet. That could block foreclosures and keep homeowners in their homes, and eliminate seizure and repossession of automobiles and other vehicles, often critical for the owner to work or seek new work. That topic is explored in depth in this troubled asset program document.[21]

However, the prospects of banks and other lenders accepting such currencies would increase dramatically should the IRS exempt complementary currencies from payment of taxes. That likelihood would become a near certainty if the FED were to also take the following action.

Get the FED to Purchase Complementary Currencies from Banks

Having IRS exempt complementary currencies from payment of federal taxes goes a long way toward making those currencies fully useful and acceptable to banks. Furthermore, state and local governments may then exempt them as well.

However, banks and other lenders may wish to convert those currencies into dollars. That's where the Federal Reserve, can enter the picture.

Let's look at the FED option.

The FED already purchases a variety of assets from banks (see this Bloomberg article *The Fed Is Buying $41 Billion of Assets Daily and It's Not Alone*[22] and this CNBC one *The Federal Reserve just pledged asset purchases with no limit to support markets.*[23])

The same should apply for the complementary currency income realized by the bank for sale of its troubled assets. Banks should be able to sell those currencies to the Federal Reserve, as they currently do for all manner of financial instruments.

Sale of Complementary Currencies By Others

There will be circumstances in which other holders of complementary currencies might want to convert them into dollars. The FED currently only purchases financial assets from banks, so that is not an option for the general public. However, the banks can provide an indirect solution for other parties who might wish to sell their complementary currencies for dollars. Here is how.

Banks (and credit unions) could serve as "currency exchanges" where anyone could exchange an alternative currency for dollars. For the general public, visiting a local institution to exchange the currency would be easy and convenient. As this would be a service, banks would likely charge a fee just as they do when exchanging foreign currencies. That could prove quite lucrative, as a few percentage points adds up quite quickly.

Additional Benefits to Banks & Credit Unions

However, banks and credit unions can realize even greater value from this process. Previously we introduced the idea of using complementary currencies to purchase troubled assets from banks.

Troubled assets represent a major and growing problem for banks and credit unions, and in fact may represent an existential threat to many, particularly smaller community institutions. That topic is explored in greater detail in the above troubled asset program document.

By selling those assets to a non-profit complementary currency issuer, those banks and other lenders can not only rid themselves of assets that threaten their financial stability, but those sales can actually result in enhanced financial performance over their current options. Here's why.

Current

Normally, a bank has to deeply discount the sale price on those assets (both loans and physical property) in order to encourage buyers to take those assets off their hands. And as the inventory of such properties grows because of the state of the economy, that problem will get worse.

Proposed

If they sell those assets for a complementary currency, the issuer of that currency could pay full price, i.e., the outstanding balance plus interest on defaulting loans and the full market value of the physical real estate.

So, lenders can not only rid themselves of assets that are dropping in value, but they can be made whole in the process. Nobody else can do that for them.

They can then sell those currencies to the FED in exchange for dollars, thereby converting troubled assets into dollars with no discount required.

Benefits to the Community

And as stated, once those mortgages and notes are acquired, the homeowner can be granted a reprieve while facing economic hardship and thus both lender and borrower will benefit. As for the physical properties purchased with this program, they can be used by the purchaser to address problems like homelessness in a community, further spreading the benefits of this program.

Banks and credit unions are continually seizing residential and commercial properties. But their increase in acquisitions during economic downturns is accompanied by an increase in demand for housing and that's where this program has a double benefit.

Any residential property, from single family homes to apartment complexes, can be purchased with a complementary currency and made available to the homeless. An additional solution now being pursued by communities across the country is converting hotels, motels and offices into homeless and low-income housing, as explored in this New York Times article,[24] this article[25] and this one.[26]

Those properties also represent a potential jobs program for many of those homeless in that many facilities are in need of repairs, upgrades and maintenance.

Lenders are not the only parties that seize properties that might be available for sale.

Just about every taxing authority from the federal government (IRS & others) on down to state and local governments have asset seizure programs for non-payment of taxes.

They too could benefit from a full market value sale rather than a discounted sale (auction) for such properties as is the current practice. Another win-win for all parties (except the sharks who buy those discounted properties).

And in the case of state and local governments, they could then take the complementary currencies received and swap them out for dollars with a bank, likely realizing far more than they might with current programs.

Acquisitions Yield Hard Assets for the Non-Profit Issuer

There is another direct impact that the acquisition of properties will have on a non-profit issuer. Those assets become tangible assets on the non-profit's books. Here's why that matters.

As pointed out in the Bloomberg and other article above about local currencies proliferating worldwide, the highlighted city Tenino, WA, issued its currency backed by dollars (its "reserve") in the city's coffers. As this article[27] points out:

> ***"Notes backed by U.S. dollars are only a halfway measure, because the amount of local currency available is limited by the amount of federal dollars the town has on hand to exchange it with."***
>
> ***It further speculates, "What happens when the nature of the reserve is changed? Let's say a local community decides to go to a more permanent solution, and takes some of its budget to buy, say, gold or silver bullion (the***

> ***real stuff, and not just paper), or for that matter, to monetize abandoned or seized property, from automobiles, or houses, or other types of hard assets sitting in its impound lots or auction warehouses? With this, the nature of the "reserve" changes from fiat currency (federal reserve notes) to hard assets. Once this decision is taken, the local currency would have material backing, and would probably begin to circulate more generally."***

Thus, a non-profit that issues its own currency to purchase tangible assets from other banks or credit unions would wind up with hard assets on its books and become ever more financially solvent. And while we do not advocate that the non-profit link these assets to their currency directly (i.e., making it an asset-backed currency which might cause it to viewed as a "security,")[28] the currency nonetheless should be viewed as even more stable as its issuer is increasingly financially stronger.

Thereafter, if the non-profit issues more currency to pay for infrastructure or other projects, the money so issued would likely have greater tangible value than is the reality for many government-issued currencies. Fiat currencies like the dollar are not backed by any tangible assets[29] (like gold), but simply the "full faith and credit of the United States".

And when it comes to the purchase of those currencies by the FED, they will likely have greater real value than the vast majority of financial assets that the FED currently purchases from other banks.

How To Implement This Recommendation

When we turn to the process by which banks and credit unions can sell the complementary currencies they receive in exchange for dollars, would the Federal Reserve be able to purchase those currencies and provide those institutions U.S. dollars in return?

> Although an instrument of the U.S. Government, the Federal Reserve System considers itself "an independent central bank because its monetary policy decisions do not have to be approved by the President or anyone else in the executive or legislative branches of government, it does not receive funding appropriated by Congress, and the terms of the members of the board of governors span multiple presidential and congressional terms."[30] Many believe that the FED is fully independent from any oversight by the federal government, but that is not correct.

> The Federal Reserve was created by Congress[31] and Congress has amended its charter on multiple occasions as changing conditions required. And according to the FED website "The Federal Reserve is accountable to the public and the U.S. Congress."[32] Ben Bernanke, the former FED chairman famously reminded his successor Janet Yellen that "Congress is our boss."[33] How Congress controls the FED is explored in greater detail in this article *How Congress Governs the Federal Reserve*[34] and this article *Who's the Boss? How Congress holds monetary policymakers accountable*.[35]

> So, Congress (not the president) has the power over the FED and a request can be made to implement the above recommendation by the Senate Committee on Banking, Housing, and Urban Affairs or the House Committee on Financial Services, both of whom have jurisdiction over the FED. But like the potential impermanence of executive branch actions, voluntary decisions by the FED can be reversed.

However, Congress can take a more definitive step and mandate such action in legislation.

The basic instruction to authorize and require the Treasury under the IRS to exempt community currencies issued by non-profit organizations for purposes of economic development, and to purchase complementary currencies from banks and credits unions entails relatively simple legislation.

Likewise, an order to the FED to purchase complementary currencies from banks and credit unions would not require much in the way of legislative language.

We have included a proposed rider in the Appendix below that incorporates the terms defined above.

Congressional Action Needed

The two key recommendations above, getting the IRS to exempt complementary currencies issued for local economic development from taxes, and having the FED purchase such currencies from banks wishing to sell them, can be accomplished with a small rider in just about any legislation. Both may be incorporated in one small section or each individually. The Appendix contains suggested language for such legislation.

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Proposed Legislation

Community Virtual Currencies Issued by Non-profits under

§ 501(c)(3) and § 501(c)(4) of U.S. Code Title 26

1. U.S. Code Title 26, Subtitle A, Chapter 1, Subchapter F, Part 1, Section 501 shall be modified to include a new subsection (s) as follows:

§ 501(s) Transactions in Community Virtual Currencies Exempt from Taxation

All financial transactions made with a community virtual currency issued for purposes of localized economic development by entities formed under § 501(c)(3) and § 501(c)(4), shall be exempt from federal taxation.

2. Any non-profit organization formed under § 501(c)(3) and § 501(c)(4) shall be exempt from having to register with FinCEN as a money services business.

3. All federal agencies that have oversight of state and federally chartered banks and credit unions shall treat any community virtual currencies issued by non-profit organizations under U.S. Code Title 26, § 501(s), and held by a state or federally chartered bank or credit union, as equal to U.S. dollars for purposes of determining such things as, but not limited to: reserve requirements, insurance payments, balance sheet evaluations, etc. The value of said currencies shall be equivalent to/on par with the U.S. dollar established by the issuing non-profit organization.

In the case of banks, the Federal Deposit Insurance Corporation shall accept such community virtual currencies for partial or full payment of required insurance payments due from that bank as though said payment were in U.S. dollars. In the case of credit unions, the National Credit Union Share Insurance Fund shall accept such community virtual currencies for partial or full payment of required insurance payments due from that credit union as though said payment were in U.S. dollars.

4. Should any state or federally chartered bank or credit union wish to exchange any community virtual currency held by said bank or credit union and issued by a non-profit organization under U.S. Code Title 26, § 501(s) for U.S. dollars from the Federal Reserve, the Federal Reserve shall purchase said currency from the requesting bank or credit union. The value of said currencies shall be the dollar equivalent established by the issuing non-profit organization.

Endnotes

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