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Crypto Winter Series: Can the Legal World Catch Up with the Rapid Development of Crypto Innovation? | Part 3 of 3

Much discussion has been had recently about the fact that cryptocurrencies (tokens and coins) do not fit neatly into a generally accepted financial asset classification. The value of most cryptocurrencies is not pegged to any tangible commodity or fiat currency. Most of the [classification debate surrounding cryptocurrencies](#) in the bankruptcy realm has focused on the question of whether they should be treated as currency or commodities. Outside of bankruptcy, the discussion also includes whether they should be treated as securities.

These classifications carry certain regulatory concerns and obligations which could lead to dramatically different results for cryptocurrency investors. There has yet to be a bankruptcy court case to resolve the currency versus commodity debate, and the securities classifications are pending in other proceedings. Hence, the date upon which cryptocurrency is valued for bankruptcy purposes is entirely unsettled. The U.S. Bankruptcy Code treats currency, commodities, and securities differently, and holders of one may get certain protections that the other may not. For now, we'll focus on the currency versus commodity distinction.

Get up to speed by reading [Part 1](#) and [Part 2](#) of our Crypto Winter series.

Classifying Crypto as a Currency vs. Commodity and the Impact Upon Investors' Legal Position

The classification of a digital currency impacts avoidance powers under the U.S. Bankruptcy Code. The debate triggers the question of what value a debtor or trustee can recover upon avoidance of a prepetition cryptocurrency transaction. Can the actual cryptocurrency that was transferred be recovered? If not, should

the debtor be able to recoup the value of the cryptocurrency on the date of the transfer, on the date that the petition is filed, or on the date of the avoidance action? Some argue that the date of the petition makes the most sense since it will place a value on the cryptocurrency asset on the date which it should have been included in the debtor's estate but for the prepetition transfer having occurred. This approach would account for the inherently volatile nature of cryptocurrency prices and provide a structural foundation for legally determining the value of cryptocurrency assets.

Asset classification of cryptocurrency is important to the bankruptcy process because it determines the date upon which the court will value the cryptocurrency asset. Classification also impacts the application of the automatic stay, as discussed in [our last article](#). The debate often focuses on the viewpoints of traditional asset regulators and government players—namely the Commodities Futures Trading Commission (CFTC), the Internal Revenue Service (IRS), the Securities and Exchange Commission (SEC) and the United States Treasury Department (Treasury). The CFTC has determined that cryptocurrency is a commodity, and similarly the IRS equates cryptocurrency to property.

The CFTC takes the position that since there is a futures trading complex for cryptocurrency, then it must be a commodity. By contrast, the SEC and U.S. Treasury have taken the position that Bitcoin is currency when arguing that virtual currency should be regulated in the same manner as real currency. To make things more complex, different tokens or cryptocurrencies may be classified differently depending on whether they are considered a currency, a store of value, or whether they have some other type of unique functionality or utility.

What Does All of This Mean Going Forward?

Ultimately, if cryptocurrency is found by a bankruptcy court to be currency, then the debtor or a trustee can only recover the value of the cryptocurrency on the date of the transfer. Further, a currency classification carries a higher degree of protection under the Bankruptcy Code. If cryptocurrency is determined to be a

commodity, then the bankruptcy court could award the debtor or trustee the value of the cryptocurrency on the date of recovery or judgment to place the estate in the same position that it was in prepetition. Commodity classification affords a transaction much less protection from the trustee's avoidance powers.

Asset classification and valuation methodology will surely be even more important issues as these matters proceed, since many [customers of Voyager](#) (or others) may have an expectation that their cryptocurrencies are assets akin to traditional securities investments and in turn will claim that they are not just ordinary unsecured creditors but in fact holders of priority claims that should be permitted to recover the actual cryptocurrency that they deposited in-kind. Similarly, debtors and trustees will argue that customers transferred their cryptocurrency to a platform fully understanding that they no longer owned the actual cryptocurrency and that those assets would be commingled with a debtor's other assets. Hopefully, these issues and many others will be addressed by the courts overseeing the 3AC and Voyager bankruptcy cases.

We will continue to update readers on how these proceedings play out and on other legal developments in future posts on our [Blockchain & Banking Blog](#). In the meantime, check out Parts 1 and 2 of our "Crypto Winter" series covering recent bankruptcies and important legal principles and protections that every crypto investor should know:

Crypto Winter Series

- [*Part 1: What Are the Current Insolvency Concerns and What Do They Mean?*](#)
- [*Part 2: Bankruptcy, Insolvency, and Liquidation Principles for Crypto Investors*](#)

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