

Silicon Valley Bitcoin

VIRTUAL CURRENCY AND TAXATION

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May 20, 2014

TOPICS

- Nature of tax issues
- Notice from IRS
- Examples and issues that exist

NATURE OF THE TAX ISSUES

TAX CONSIDERATIONS

Virtual Currency Action	Possible Tax Effects
Mining	<ul style="list-style-type: none"> Income – accession to wealth Self-employment tax – if is a business
Use to buy goods and services	<ul style="list-style-type: none"> Determine basis – same as if used US Dollar Income - Gain or loss on VC between time acquired and used
Buy and sell VC	<ul style="list-style-type: none"> Income tax – gain or loss (as if selling stock or gold) Sales tax – subject to sales tax? VAT – subject to VAT?
Holding, such as for investment	<ul style="list-style-type: none"> Reporting – FBAR? Foreign financial asset (Form 8938)? Estate tax – if estate large enough and hold at death
Give to someone	<ul style="list-style-type: none"> Gift tax – if given with disinterested and detached generosity – may owe gift tax Recipient needs to know giver's basis
Ripped off / stolen	<ul style="list-style-type: none"> Income tax – theft loss?

CONCERNS OF TAX AGENCIES

"The Department of Justice recognizes that many virtual currency systems offer legitimate financial services and have the potential to promote more efficient global commerce. We have also seen, however, that certain aspects of virtual currencies appeal to criminals and present a host of new challenges to law enforcement."

- Dept. of Justice, Acting Asst Attorney General Mythili Raman, 11/18/13 hearing of Senate Committee on Homeland Security and Government Affairs – "Beyond Silk Road: Potential Risks, Threats and Promises of Virtual Currencies"

<http://www.hsgac.senate.gov/download/?id=ac50a1af-cc98-4b04-be13-a7522ea7a70d>

TAX ANONYMITY?

- Maybe
 - Concern of IRS and other tax agencies and lawmakers
- Likely not anonymous – other documents or evidence exists
- What tracking is available?
 - Normal business records (invoices, etc.)
 - Records of others involved in the transaction
 - The Blockchain?



EXAMPLE

- Selling your home in exchange for Bitcoin
 - Advertised on web
 - Legal documents needed to transfer title
 - Tax reporting requirements also needed
- Won't be anonymous



IRS NOTICE 2014-21

<http://www.irs.gov/pub/irs-drop/n-14-21.pdf>
<http://21stcenturytaxation.blogspot.com/2014/03/guidance-on-taxation-of-virtual-currency.html>

GENERAL RULE

- Applies to convertible virtual currency
- Treat as property for federal tax purposes
 - Not as currency.

IRS Virtual Currency Guidance

Notice 2014-21

SECTION 1. PURPOSE

This notice describes how existing general tax principles apply to transactions using virtual currency. The notice provides this guidance in the form of answers to frequently asked questions.

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IRS NOTICE 2014-21

Meaning ...

- As if you were using gold to pay for your transactions.
- Need to track the value of the VC when purchased/acquired and when used.
 - Character (normal rules should apply)
 - Dealer – ordinary income
 - Trader or investor – capital gain/loss
 - Tracking can be a challenge if use VC often

MORE ON MEANING

- Mine Bitcoin – generate income!
 - May also owe self-employment tax if is a trade or business.
 - Assumption seems to be:
 - Working (computing) to obtain something.
 - Finding something (for example, finding money or a treasure trove is income).
- Use VC for business transactions
 - Pay employees in it – include in W-2
 - Pay contractor in it – include in 1099 (if \$600 or more)

HOW

- Determine FMV of the VC in US dollars as of date of payment or receipt.
- Done in a reasonable manner, consistently applied.
 - Meaning?
 - Use same exchange calculator for all transactions?
 - Be consistent on value selected.
 - What is reasonable?
 - Average for the day?
 - Close of your business day?

EXAMPLE

- October 1, 2012
 - Jane buys 100 VC for \$100 (\$1/VC)
- February 2, 2013
 - Jane buys 100 VC for \$150 (\$1.50/VC)
- May 20, 2014
 - Jane uses 50 VC to buy \$85 of goods on Overstock.com
 - So, value is \$1.70/VC
- Tax consequences
 - Overstock – gross receipts of \$85
 - Jane – goods valued at \$85
 - Jane – long-term capital gain of \$35 (if used the 2012 VC)
 - $\$0.70 \times 50 = \35

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ISSUES

- What exchange rate to use?
 - End of day? Average for the day? Something else?
- Track by specific identification or FIFO?
 - Existing regulations allow either approach for sale of stock
 - Will IRS allow for virtual currency?
 - Jane needs to keep record that she used 50 of her \$1/VC basis VC.

ISSUES - MORE

- Is obtaining VC always income?
 - IRS Q&A 8 – Taxpayer who “mines” VC “(for example, uses computer resources to validate Bitcoin transactions and maintain the public Bitcoin transaction ledger) realize gross income upon receipt of the virtual currency resulting from those activities.”
- Some may argue that “mining” is like a carpenter making a table. The table is not income until it is sold.
 - But, seems that the Bitcoin miner is not making something, but more like finding something. And, there is a finite amount of Bitcoin.
- Should the answer be different for a “miner” who mines only to sell Bitcoin – is a dealer? Is that more like the carpenter? Or does it matter that the miner did not create the Bitcoin?

EXAMPLE

- Bitcoin Meetup
 - Give x Bitcoin to an attendee using QR code
 - Tax effect to both parties?
- Gift?
 - Not taxable to recipient. Should be no deduction to giver.
 - Generally, recipient has same tax basis as giver.
 - How will recipient know that basis?
- Business transaction?
 - Deductible by giver as promotional expenditure (assuming giver is in a business)?
 - Taxable to recipient (giver expects something from you)?
 - Use FMV at time of transfer.



SUMMARY

- Follow the IRS Notice 2014-21
 - States likely to follow for state income tax purposes too.
- Be aware of open issues
 - How to track your basis of the VC you use?
 - What exchange rate tool to use and when?
 - Is the VC considered a foreign cash asset (FBAR reporting) or foreign financial asset (Form 8938 reporting)? [\[for your international digital wallet\]](#)
 - Others
- Treatment may be different in other countries
 - Example – UK says income from Bitcoin mining not subject to VAT
 - But likely subject to income tax.
- Likely to see more guidance from IRS and from states.

ARE THERE ONLY TAX ISSUES AND CONCERNS?

Or also tax applications and efficiencies?



MORE INFO AND LINKS

<http://www.21stcenturytaxation.com>

See link on Virtual Currency & Tax