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Bitcoin In IRS Crosshairs, Says Government Report

[Bitcoin](#) is virtual currency with no central bank or government. What does the federal government think of it? The IRS could do a better job telling people they have to pay tax on Bitcoin transactions, says a recent Government Accountability Office (GAO) [report](#). The [report](#) gives a few simple examples too:



1. Bill is a Bitcoin miner. He successfully mines 25 Bitcoins. Bill may have earned taxable income from his mining activities.
2. Carol makes T-shirts and sells them over the Internet. She sells a T-shirt to Bill, who pays her with Bitcoins. Carol may have earned taxable income from the sale of the T-shirt.

In short, people trading in Bitcoins may **think** they are avoiding taxes. But they are not, at least not always. And forget IRS silence. The IRS is unlikely to continue its watchful waiting, it seems. The new report says the IRS should watch Bitcoin and other virtual currencies closely.

Why? Exactly why you'd think. Virtual property and currency can be exchanged for real goods, services, and currency. That means transactions that should generate tax dollars for Uncle Sam. Yet virtual currencies raise obvious tax compliance problems. What should the IRS do?

Regulate it, says GAO. See [GAO: IRS Needs to Keep an Eye on Virtual Currencies](#). The IRS started watching such issues in 2007. In 2009, the IRS posted information on its website on the tax consequences of virtual economy transactions. However, IRS has not provided taxpayers with information **specific** to virtual currencies. Does that mean IRS doesn't care?

Nope, but GAO says the lack of formal guidance can cause some people to **assume** tax doesn't apply. GAO recommends that IRS disseminate the basic tax reporting requirements. Already, the IRS has agreed.

Since many Bitcoin transactions are essentially bartering, the IRS can be expected to draw from its [Bartering Tax Center](#). Soon the IRS may have a Bitcoin Center too. The Treasury unit called FinCEN, the Financial Crimes Enforcement Network, already has [rules about Bitcoin](#) and the IRS is likely to follow.

In the meantime, the tax rules seem pretty clear. If you provide services or sell goods for Bitcoin, you have income. If you exchange Bitcoins for cash, whether you have gain may depend on whether Bitcoin is really currency or commodity. The latter seems more likely, meaning you have gain to the extent of the appreciation in your Bitcoin.

Income is income, whether you get it in cash or in kind. Bitcoin may be accepted as currency and may not be easy to trace but so are trades and barterers. When you barter or swap one item for another, both parties have tax consequences. That's so even if one party wants credit for later. See [IRS Takes A Bite Out Of Bitcoin](#).

Form 1099 Reporting? [Information reporting requirements](#) don't apply specifically to transactions using virtual economies or currencies, right?

Maybe, but they aren't explicit exempt either. Virtual economy or currency transactions may be subject to third-party information reporting to the extent that these transactions involve the use of a third-party payment network to mediate the transaction and the taxpayer meets reporting threshold requirements. The government worries these things are inherently difficult to track. They want to identify the true identities of the parties.

Tax Evasion. Is Bitcoin a way to [evade taxes](#)? The report agrees these transactions are difficult to trace. Some taxpayers may use them to hide taxable income. Many more just haven't thought about taxes.

There is confusion whether transactions in Bitcoin should be treated as property, barter, foreign currency, or a financial instrument. How you see it

can determine the tax treatment. Barter transactions may be the most logical treatment, but not everyone agrees. Besides, even without Bitcoins or other exotica, bartering transactions are inherently under-reported. See [Trades And Swaps? IRS Gets A Piece \(Really\)](#).

And then there is tax basis. If you sell something for less than you paid, you shouldn't have gain. That's true in U.S. dollars or in Bitcoin. If you sell something at a garage sale, you may or may not have income.

Brave new world? GAO and IRS don't think so.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.