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By Dashiell Shapiro

Could Milton Friedman’s “Least Bad Tax” Work for Cryptocurrencies? Expert Blog



EXPERT BLOG

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With Washington D.C. abuzz with tax policy debate, it’s worth asking what Congress will do when it eventually focuses on cryptocurrencies in its hunt for revenue. For now, the feds haven’t said much. In 2014, the [IRS](#) declared only that Bitcoin is “property” and Congress has said almost nothing.

But with [Bitcoin](#) surpassing \$8,000, the feds will surely be looking for more tax revenue from cryptocurrencies. But how to tax Bitcoin? One ancient approach, which could ironically get a closer look, is the Land Value Tax.

Land Value Tax in theory

The Land Value Tax (LVT) is essentially what it sounds like, a tax on the value of land. It's quite popular among economists, although not frequently used in practice. Adam Smith said nothing could "be more reasonable" than the LVT. Milton Friedman famously called it the "least bad tax." Well put.

One reason economists like the LVT is because it arguably distorts economic activity less than other taxes. Corporate taxes reduce incentive to invest, income taxes can distort incentives to earn income, and so forth.

But in theory, if there was a one percent LVT introduced today, there would still be as much land next year as there is today. The supply of land doesn't (and can't) change. All that changes is price, as LVT becomes factored into the price of land.

But would this work?

Now, there are certainly some problems with this reasoning, and especially as it relates to Bitcoin and other cryptocurrencies. For one, cryptocurrencies aren't exactly like land and an LVT on cryptocurrencies could affect future supply. While the supply of Bitcoin is fixed in a sense, the incentives to invest in creating additional cryptocurrency through [forks](#) or [ICO's](#) could be muted by an LVT.

Also, enforcement and collection could be tricky. How would tax authorities know if the holder of a Bitcoin is a tax resident of any particular jurisdiction? How would they impose and collect the tax? Perhaps the tax could be collected on the Blockchain itself, although with current technology it's hard to see how this would work. Enforcement could require intrusive -- and exceedingly unpopular -- measures.

However, assuming these and other problems could be worked out (a big if), there are some possible advantages to imposing an LVT on cryptocurrencies. One of the criticisms usually leveled at LVTs is that it is difficult to value land separately from what is built upon it. This might explain why LVTs are not very common, even though economists praise them.

But generally speaking, there's nothing "built" on any particular Bitcoin, and one Bitcoin has the same value as the next. The value is therefore readily ascertainable for tax purposes, and imposing an LVT could (again, a big "if") impose less distortion than taxes on trading gains, mining, and other economic activity connected to the [Blockchain](#). When Congress eventually sets its sights on the Bitcoin economy, it may look to some form of an LVT.

Milton Friedman – the prophet for crypto?

In addition to praising the LVT, Milton Friedman may also have predicted the rise of Bitcoin almost 20 years ago. In a 1999 interview conducted by NTU/F:

"The one thing that's missing, but that will soon be developed, it's a reliable e-cash. A method where buying on the internet you can transfer funds from A to B, without A knowing B or B knowing A. The way in which I can take a 20 dollar bill and hand it over to you and there's no record of where it came from. And you may get that without knowing who I am. That kind of thing will develop on the Internet."

Milton Friedman may have been thinking of something quite similar to Bitcoin when he made these remarks. His remarks seem downright prophetic now. The question of how to tax Bitcoin may be a new one, but the policy questions have been around for some time.

Maybe Milton Friedman was even thinking of assets like Bitcoin when he praised the LVT. But was Adam Smith, when he said nothing could be “more reasonable” than an LVT? Probably not...

Still, when Congress turns its sights to cryptocurrencies as a potential source of revenue, it will be interesting to see what ancient method of [taxation](#) they try to fit onto this modern technology.

Dashiell Shapiro

Dashiell Shapiro is a Tax Partner at Wood LLP in San Francisco, CA, and a former DOJ Tax Attorney. His practice focuses on tax controversy and audit defense, and includes international tax and financial products/cryptocurrency tax planning work.